No. 14334

United States
Court of Appeals
for the Ninth Circuit

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,
Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC.,
Appellees.

Transcript of Record

In Two Volumes

VOLUME I.

(Pages 1 to 292, inclusive)

Appeal from the United States District Court for the Southern District of California, Central Division

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

PAGE

Answer of Defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. 20

Answer of Defendants Sperling and United States Pictures 16

Appeal:

Certificate of Clerk to Transcript of Record on 103

Notice of 101

Order Submitting Motion re Record on Appeal and Granting Motion in Part on (USCA) 595

Statement of Points on Appeal and Assignment of Errors on (USCA) 591

Certificate of Clerk to Transcript of Record ... 103

Complaint 3

Findings of Fact and Conclusions of Law 71

Judgment of Dismissal 82

Names and Addresses of Attorneys 1

Notice of Appeal 101

Notice of Motion for Leave to Amend Complaint to Conform to Evidence 84
Order Denying 100

Notice of Motion for Leave to File Amended and Supplemental Complaint 36
Order Denying 50

Objections of Plaintiff to Findings of Fact and Conclusions of Law 57

Order Denying Motion for Leave to Amend... 100
Order Denying Motion for Leave to File Amended and Supplemental Complaint..... 50

Order Submitting Motion re Record on Appeal and Granting Motion in Part (USCA)..... 595

Statement of Points on Appeal and Assignment of Errors (USCA) 591

Stipulation Concerning Other Stockholders' Cases 52

Stipulation dated Feb. 15, 1954, Providing that all Plaintiff's Claims Set Forth in Proposed Amended and Supplemental Complaint were Brought to the Attention of the Trial Court during Trial of the Above Entitled Matter.. 101

Stipulation of Facts 26

Transcript of Proceedings and Testimony..... 105

Depositions (In Part)

Bernhard, Joseph 333-345
Bierwirth, John 208-220
Birn, Edward S. 198-204

Transcript of Proceedings—(Continued)

Depositions (In Part)—(Continued)

Carlisle, Samuel 170-196
Catchings, Waddill 243-269
Guggenheimer, C. S. 270-285
McDonald, W. Stewart 221-232
Perkins, Robert W. 293-308
Schwab, Oliver B. 345-346
Sperling, Milton 573
Warner, Albert 232-242
Warner, Harry M. 317-329
Warner, Jack L. 308-316
Wolf, Morris 285-292
Yoss, Joseph Charles 350-363

Exhibits for Plaintiff (In Part):

22—Deposition of Edward S. Birn 198-204
93-A—Minutes of a Special Meeting of the Board of Directors of United States Pictures, Jan. 2, 1947 347-350
95-H—Amended Income Tax Return for Calendar Year 1948, United States Pictures, Inc. 363-366
108-108A—Requests for Admissions directed to Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc., and Answers 112-114
109—Request for Admissions addressed to Milton Sperling and United States Pictures and Answers 115-116
110—Requests directed to Harry M. Warner and Jack L. Warner 117-151

Transcript of Proceedings—(Continued)

Exhibits for Plaintiff (In Part)—(Continued)

111—Answers by Warner Brothers Pictures, Inc., to Requests for Admission.... 151-157
112—Requests for Admissions addressed to Milton Sperling 157-170
113—Deposition of Samuel Carlisle..... 170-196
114—Deposition of W. Stewart McDonald 221-232
115—Deposition of Albert Warner..... 232-242
116—Deposition of Waddill Catchings... 243-269
117—Deposition of C. S. Guggenheimer.. 270-285
118—Deposition of Morris Wolf..... 285-292
119—Deposition of Robert W. Perkins.. 293-308
120—Deposition of John Bierwirth..... 208-220
121—Deposition of Jack L. Warner..... 308-316
122—Deposition of Harry M. Warner... 317-329
123A—Deposition of Joseph Bernhard.. 333-345
124—Deposition of Oliver B. Schwab.... 345-346
125A—Deposition of Joseph Charles Yoss 350-363
126—Statement of Charles Joseph Yoss..... 379

Exhibits for Defendants (In Part):

G—Memorandum of Herbert Freston re Second Draft of Contract and Points in Issue Discussed with Mr. Schwab.. 397-404
J—Statement of Herbert Freston re Source Material 407-432
L—Analysis made by Stanleigh P. Friedman of Amendatory Agreement 467
M—Deposition of Milton Sperling..... 573

Transcript of Proceedings—(Continued)

Witnesses:

Blumenstock, Morton Barnard
—direct 575

Freston, Herbert
—direct 383
—recalled, cross 573

Friedman, Stanleigh P.
—direct 443
—recalled, direct 463
—cross 480

Obringer, Roy John
—direct 196
—recalled, direct 366
—cross 375
—redirect 378

Schneider, Samuel
—direct 507
—cross 555
—recalled, cross 581

Yoss, Joseph Charles
—recalled, cross 583
—recross 583

	Original	Print
Record from U.S.D.C. for the Southern District of California, Central Division	597	597
Plaintiff's Exhibit 21—Excerpts from Notice of annual meeting of stockholders, dated January 10, 1946, and proxy statement	597	597
Plaintiff's Exhibit 17—Waiver of notice and minutes of a special meeting of the Board of Directors, dated September 25, 1945	603	601
Plaintiff's Exhibit 123B—Excerpts from agreement dated October 24, 1941 between Warner Bros. & Joseph Bernhard	606	603
Plaintiff's Exhibit 18—Waiver of notice and minutes of a special meeting of the Board of Directors, dated September 28, 1945	608	605
Plaintiff's Exhibit 107—Letter from Warner Bros. Pictures, Inc., West Coast Studios, to United States Pictures, Inc., dated August 12, 1952	610	606
Clerk's certificate (omitted in printing)	612	
Plaintiff's Exhibit 1—Contract between Warner and United, dated September 28, 1945	613	607
Plaintiff's Exhibit 4—Contract between Warner and United, dated December 6, 1947	667	651
Plaintiff's Exhibits 22 D & 22 E—Business reply postal cards to Warner Bros. Pictures, Inc.	671	657
Defendants' Exhibit B-1-A—Chart showing benefits to August 31, 1952 to Warner Bros. resulting from production and distribution of pictures of independent producers	673	659
Defendants' Exhibit B-2-A—Chart showing excess (deficiency) of gross receipts over production cost at Aust 31, 1952	674	660

	Original	Print
Record from U.S.D.C. for the Southern District of California, Central Division—Continued		
Defendants' Exhibit B-3-A—Chart showing No. of pictures released September 1, 1945 to August 31, 1952	675	661
Defendants' Exhibit B-6-A—Chart showing Comparison of Benefits to Warner Bros. to August 31, 1952 if all U.S. U. pictures productions had been produced (1.) as "original" pictures, and (.) as "additional" pic tures	676	662
Defendants' Exhibit B-7-A—Chart showing Total W.B. overhead for various weeks, etc.	677	663
Proceedings in U.S.C.A. for the Ninth Circuit	678	665
Argument and submission (omitted in printing)	679	
Minute entry of order directing filing of opinion and filing and recording of judgment	680	665
Opinion, Feé, J.	681	665
Judgment	690	674
Clerk's certificate (omitted in printing)	691	
Order allowing certiorari	692	675

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* Page numbers appearing at foot of page of original Transcript of Record.

In the United States District Court for the Southern District of California, Central Division

No. 9005-WM

EDWARD S. BIRN, Plaintiff,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC., Defendants.

COMPLAINT

Accounting and Damages

Plaintiff herein suing derivatively on behalf of and for the benefit of defendant Warner Bros. Pictures, Inc., and the stockholders thereof, complains as follows: (All of the allegations below being upon information and belief except allegations "1" to "4" inclusive and allegation "20", which are alleged as of plaintiff's knowledge.)

For a First Cause of Action Against All The Defendants

1. Jurisdiction herein is founded on diversity of citizenship and amount. This action is not a collusive one to confer on this court jurisdiction of an action over which it would not otherwise have jurisdiction.

2. The matter in controversy exceeds, exclusive of interest and costs, the sum of $3000.

3. Plaintiff is a citizen of the State of New York. [2]

4. Plaintiff is, and has been, during the time that the transactions herein complained of occurred, the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc., having owned said stock since August 21st, 1944.

5. Defendants Warner Bros. Pictures, Inc., (hereinafter referred to as Warner Bros.) and United States Pictures, Inc. (hereinafter referred to as United), are corporations incorporated under the laws of the State of Delaware, engaged in the motion picture business and said corporations do business and maintain offices in the County of Los Angeles and State of California.

6. The defendants Milton Sperling, Harry M. Warner, and Jack L. Warner are citizens of the State of California.

7. That during the time that the transactions hereinbelow complained of occurred, the defendants, Harry M. Warner, Jack L. Warner, were directors of Warner Bros.

8. That the Board of Directors of defendant Warner Bros., presently consists of defendants Harry M. Warner, Jack L. Warner, Morris Wolf and of John. E. Bierwirth, Robert W. Perkins, Samuel Carlisle, Waddill Catchings, Stanleigh P. Friedman, Charles S. Guggenheimer, Samuel Schneider and Albert Warner.

9. That the aforementioned Harry M. Warner, Jack L. Warner and Albert Warner are brothers and the aforesaid Milton Sperling is the son-in-law of Harry M. Warner.

10. That at all times herein mentioned the de-

fendants Harry M. Warner and Jack L. Warner, together with their brother, Albert Warner owned a large and controlling block of the outstanding capital stock of Warner Bros. and said three brothers did control and dominate Warner Bros. and did actively direct its s ervision, policies, actions and business including the acts hereinafter alleged in this complaint and did actually select, dominate and control the directors and officers of Warner Bros.

11. That in or about or prior to the summer of 1945 the [3] individual defendants did, as is hereinbelow more fully alleged, illegally, wrongfully and in bad faith, conspire and act together to waste, mismanage, divert and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling and United at the expense of Warner Bros., and the different things and acts done by said individual defendants, and by the corporate defendants through their directors and officers, as hereinbelow alleged, were all steps in said conspiracy and were committed pursuant thereto.

12. That on or about August 6th, 1945, defendant United was caused to be organized by defendant Sperling with nominal capital contributions and the capital stock of said corporation was issued to Sperling and one other. That since September, 1946, defendant Sperling has been the sole stockholder of defendant United.

13. That said corporation was organized in order

that through it, the defendant Sperling might wrongfully utilize and divert from Warner Bros. the funds, credits, facilities, assets and business opportunities of Warner for his private purposes and benefits.

14. Thereafter and in or about September, 1945, the defendants caused Warner Bros. and United to enter into an agreement which provided in substance as follows:

Six motion pictures were to be produced by United at the studio, and with the facilities and personnel of, Warner Brothers. Said pictures were to be distributed by Warner Bros. through its subsidiaries, the latter to retain out of the gross proceeds of distribution certain percentages and sums as fees and expenses of distribution and the net profits from the production and distribution of said pictures were to be shared equally between Warner Bros. and United.

Warner Bros. was to advance 50% of the cost of production of said pictures and the remaining 50% of said cost was to be advanced by United. In this latter connection, however, United was authorized to borrow its entire share of the cost of production and [4] was further authorized to pledge as security for such borrowing, the pictures to be produced, including the negatives and positive prints thereof and including the entire net proceeds of the distribution of said pictures, and Warner Bros. was to agree to such pledge and thereby subordinate its investment and provide with its funds the collateral security for the loan to United.

15. That at the time of the making of said agreement, it was intended by defendants that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of said six motion pictures by means of the borrowing privileges set forth in said agreement.

16. That in furtherance of said agreement and intention as set forth in the two preceding paragraphs and in or about November 1945, the defendants caused an agreement to be entered into between Warner Bros. and United and The New York Trust Company (the latter being a New York banking corporation) for the loan by The New York Trust Company to United, of the latter's share of the cost of production of the pictures as aforesaid and under said agreement there was pledged as security for the repayment of said loans the security described in allegation "14" hereinabove; and said loan agreement further provided that after said loans had been repaid and after the share of the production costs of the pictures advanced by Warner Bros. had likewise been repaid, the net profits resulting from the pictures were to be shared equally between Warner Bros. and United.

17. That said loan agreement was effectuated through the use of the valuable credit and banking facilities and connections of Warner Bros. in that John E. Bierwirth, a director of Warner Bros., is and has been president of The New York Trust Company since 1941, and his influence was used to

effect said loan agreement, and further, in that Warner Bros. is a valued customer of The New York Trust Company and its patronage is favorably sought for various [5] reasons including the fact that Warner Bros. was then indebted to a syndicate of banks, including The New York Trust Company, to the extent of several million dollars.

18. That in pursuance of said agreements as alleged in paragraphs numbered "14" and "16" above and during the period commencing in or about November 1945 to date, United has borrowed large sums from The New York Trust Company and the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being used by United, and the said agreements have been in part performed and motion pictures are being produced and distributed under said agreements and said agreements remain in part unperformed.

19. That in connection with the performance of said agreements United has not advanced any of its private funds or capital and has contributed to the costs of production of said pictures solely out of the loans from The New York Trust Company aforementioned.

20. That plaintiff did not discover the facts set forth in allegations "11" to "19" inclusive herein until October of 1948 and plaintiff had no notice or information of circumstances which would put him on inquiry regarding such facts until October of 1948.

21. That by reason of the premises, Warner Bros. has suffered and still suffers improper and illegal

waste, mismanagement, misappropriation and diversion of its valuable assets, credits, facilities and business opportunities all to its loss and to the improper and personal profit and benefit of United, and Sperling in that;

(a) The aforesaid agreements and the amount of return or profit provided thereunder to Warner Bros. and the amount of distribution fees provided thereunder to its subsidiaries are grossly unreasonable and unfair to Warner Bros. and its subsidiaries and are not in accordance with customary agreements in the motion picture industry; and (b) Warner Bros., in effect, has been and still is providing the use of its funds, credits, facilities and assets to [6] defendant United without any adequate, reasonable or legal consideration, return, or payment to Warner Bros.; and

(c) Warner Bros. in effect, has been and still is undertaking the sole risk of capital and bearing the entire burden of the cost of production of said motion pictures involved in the aforesaid agreement, and in the event of loss in said productions, Warner Bros. will suffer the entire or principal amount thereof inasmuch as United has advanced no capital and is financially unable to meet or share any substantial losses; and despite the foregoing Warner Bros. receives only 50% of the net profits and the other 50% of the said profits goes to United, such profit divisions being grossly unfair to Warner Bros. and the receipt by United of said profits and benefits under said agreements constitutes an im-

proper and unconscionable gift or advantage to United at the expense of Warner Bros.; and

(d) The subordination and use of the capital assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes an improper or illegal use of property of Warner Bros. for which the latter receives in return no legal or adequate consideration; and

(e) The subordination and use of the capital, assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes a breach of the existing written agreement between Warner Bros. and a syndicate of banks under which Warner Bros. is the recipient of large business loans totalling several millions of dollars, and the said last named written agreement with said banks prohibits such use of the capital and assets of Warner Bros., and thereby Warner Bros. is endangering said loans and injuring its credit. [7]

22. That all of the acts and matters alleged in this complaint were then known or with the exercise of reasonable diligence should have been then known to the defendants, and all of the defendants either actively participated in said acts or matters or with knowledge of the same and the course of conduct being pursued, ratified said acts or matters or failed to take any corrective measures.

23. That by reason of the premises, the defendant United and its assets, and the profits and benefits derived by it under the above mentioned agree-

ments, are substantially based upon, result from, and stand in the place of, the assets and business opportunities wrongfully diverted from Warner Bros. to United and hence the capital stock of United and all of its said assets belong in equity and good conscience to Warner Bros.

24. Demand upon the directors of Warner Bros. to institute this action would be futile and plaintiff has made no such demand because all or a majority of the present board of directors and officers of said corporation wrongfully participated in the acts and grievances herein complained of and said board of directors is controlled by the active wrongdoers herein, and since those to whom application would have to be made to institute this suit are the same persons who wrongfully caused or permitted the grievances herein complained of, such persons would refuse to bring suit against themselves and in fact would be disqualified from faithfully doing so.

25. Plaintiff has no adequate remedy at law and he and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted.

For a Second Cause of Action Against All Defendants Except United and Sperling.

26. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "25" (except "11") inclusive with the same force and effect as though herein alleged. [8]

27. That by reason of the acts committed by these defendants as herein alleged, the individual defend-

ants, while acting in their fiduciary capacities and while charged with their fiduciary duties as directors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, nonfeasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

For a Third Cause of Action Against All Defendants Except United and Sperling.

28. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "10" inclusive and "24" and "25" with the same force and effect as though herein alleged.

29. That heretofore and prior to December 8, 1942, defendants caused Warner Bros., in conspiracy and concert with other large motion picture producing and distributing companies, to illegally and wrongfully combine and monopolize the distribution by Warner Bros. and certain of its subsidiaries, of motion picture in the city of Philadelphia, state of Pennsylvania, in restraint of trade and in violation of the laws of the United States, known as the Sherman Anti-Trust Act (15 U.S.C.A.1) and the Clayton Act (15 U.S.C.A. 15).

30. That thereupon on December 8, 1952, William Goldman Theatres, Inc., a corporation engaged in business as a motion picture distributor and exhibitor in Philadelphia, claiming to be aggrieved by said monopoly, brought suit in the United States

District Court for the Eastern District of Pennsylvania against Warner Bros. and its said subsidiaries and said other motion picture companies, which suit was entitled William Goldman Theatres, Inc., vs. Loews, Inc., and in which suit the plaintiff therein sought to enjoin said monopolistic practices and to recover from the defendants therein triple the damages suffered by said plaintiff as the result of said practices. [9]

31. That said suit terminated on December 8, 1946, in a judgment for the plaintiff therein which judgment decreed that the defendants in that suit were all guilty of illegal monopoly in violation of the Sherman Anti-Trust Act and which judgment enjoined said defendants from monopolistic practices and awarded to the plaintiff therein treble damages amounting to $375,000, plus $60,000 for said plaintiff's counsel fees. Said judgment was affirmed by the United States Circuit Court of Appeals on January 6th, 1948, and certiorari was denied by the United States Supreme Court on May 3, 1948. That said total award of $435,000 was thereafter paid by said defendants to said plaintiff on or about May 23, 1948.

32. That subsequently said plaintiff's counsel obtained from said United States District Court an additional allowance against said defendants of $15,000 for additional legal services in said lawsuit, which additional counsel fee allowance was paid by said defendants.

33. That of the said total amount of $450,000 paid to William Goldman Theatres, Inc., and its

counsel, by the defendants in the said lawsuit, Warner Bros. and its subsidiaries contributed a large, if not a major aliquot share amounting to several thousands of dollars.

34. In connection with said lawsuit, Warner Bros. and its subsidiaries also suffered and paid out many thousands of dollars in counsel fees and expenses incurred by them in the defense of said action.

35. That the acts of Warner Bros. and its subsidiaries through their officers, agents and employees, upon which the aforesaid judgment was based, were in violation of the aforesaid laws of the United States and were against public policy.

36. That said acts of Warner Bros. and its subsidiaries were caused to be committed by the individual defendants herein as directors of Warner Bros. although said defendants then knew or [10] with the exercise of reasonable diligence should have then known that said acts were in violation of said law.

37. That the individual defendants willfully or negligently actively participated in causing Warner Bros. and its subsidiaries to perform the aforesaid acts or else with knowledge of the course of conduct being pursued ratified said acts and failed to take corrective measures.

38. That if not for the negligence or willful acts of defendants as aforesaid Warner Bros. would not have engaged in said illegal acts and would not have been subject to the aforesaid lawsuit and

would not have been obliged to pay out the large sums of money as aforesaid.

39. That by reason of the acts committed by these defendants as herein alleged, the individual defendants, while acting in their fiduciary capacities and while charged with their fiduciary duties as directors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, non-feasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

Wherefore plaintiff demands judgment as follows:

(1) That the defendants account to Warner Bros. for all losses and damages suffered by it and its subsidiaries and for all profits and benefits received by said defendants, and that defendants make restitution accordingly.

(2) That a trust be impressed upon the capital stock and assets of United in favor of Warner Bros.

(3) That the agreement between Warner Bros. and United to the extent that the same is unexecuted and to the extent that it is practicable to do so, should be cancelled and terminated.

(4) That plaintiff be allowed the costs, disbursements and expenses of this action, including reasonable counsel and accountants' [11] fees.

(5) That such other and further relief be granted as shall be equitable in the premises.

SIDNEY A. MOSS,
GEORGE C. LYON,
/s/ By SIDNEY A. MOSS,
Attorneys for Plaintiff. [12]

Duly Verified. [13]
[Endorsed]: Filed December 15, 1948.

[Title of District Court and Cause.]

ANSWER BY DEFENDANTS SPERLING AND UNITED STATES PICTURES, INC.

Defendant Milton Sperling and defendant United States Pictures, Inc., in answer to the complaint herein for themselves only, state:

First Cause of Action.

1. Said defendants deny each and every allegation contained in Paragraphs 2, 11, 13, 15, 19, 21, 21(a), 21(b), 21(c), 21(d), 21(e), 22, 23 and 25 of the complaint.

2. Said defendants are without knowledge or information sufficient to form a belief as to the truth of any of the allegations contained in Paragraphs 3, 4, 8, 10, 20 and 24 of the complaint.

3. Said defendants deny the allegations contained in Paragraph 12 of the complaint, except that they admit that United States Pictures, Inc. was organized on or about August 6, 1945.

4. Said defendants deny the allegations contained

in Paragraph 14 of the complaint except that they admit that on or about September 28, [14] 1945, the defendant Warner Bros. Pictures, Inc. and defendant United States Pictures, Inc. entered into a written agreement concerning the production by United States Pictures, Inc. of motion pictures, to which agreement the Court is respectfully referred for the true terms, provisions and conditions thereof.

5. Said defendants deny the allegations contained in Paragraph 16 of the complaint except that they admit that in or about November, 1945, a written agreement was entered into between defendant Warner Bros. Pictures, Inc., defendant United States Pictures, Inc. and The New York Trust Company concerning loans by the latter to United States Pictures, Inc. for use in producing motion pictures, to which agreement the Court is respectfully referred for the true terms, provisions and conditions thereof.

6. Said defendants deny the allegations contained in Paragraph 17 of the complaint except that they admit that John E. Biervirth has been president of The New York Trust Company for some period of time.

7. Said defendants deny the allegations contained in Paragraph 18 of the complaint except that they admit that defendant United States Pictures, Inc. has borrowed sums of money from The New York Trust Company and that the agreements referred to in the foregoing paragraphs 5 and 4 of this Answer have been in part performed, that mo-

tion pictures are being produced and distributed under said agreements and said agreements remain in part unperformed.

Second Cause of Action

8. Said defendants repeat and reallege each and every allegation contained in Paragraphs 1 to 7 above by way of answer to Paragraph 26 of the complaint.

9. Upon information and belief, said defendants deny the allegations contained in Paragraph 27 of the complaint.

Affirmative Defense to First and Second Causes of Action.

10. Each said cause of action did not accrue within three years before the commencement of this action and that said action is barred. [15]

Second Affirmative Defense to First and Second Causes of Action.

11. Each said cause of action did not accrue within three years before the commencement of this action and that said action is barred by the New York Statute of Limitations.

Third Affirmative Defense to First and Second Causes of Action

12. The causes of action set forth in the complaint did not accrue within two years before the commencement of this action and that said action is barred by the California Statute of Limitations.

Fourth Affirmative Defense to First and Second Causes of Action.

13. Each said cause of action did not accrue within three years before the commencement of this action and that said action is barred by the California Statute of Limitations.

Fifth Affirmative Defense to First and Second Causes of Action.

14. Each said cause of action did not occur within three years before the commencement of this action and that said action is barred by the Delaware Statute of Limitations.

Sixth Affirmative Defense to First and Second Causes of Action.

15. The complaint fails to set forth with particularity the efforts of the plaintiff to secure from the managing directors or stockholders of the defendant Warner Bros. Pictures, Inc. such action as plaintiff desires and the reasons for his failure to obtain such action or the reasons for not making such effort. Such reasons as plaintiff does allege in Paragraph 24 of the complaint are insufficient to excuse efforts by the plaintiff to secure from the directors and shareholders of Warner Bros. Pictures, Inc. such action as plaintiff desires. [16]

Seventh Affirmative Defense to First and Second Causes of Action.

16. Both the First and Second Cause of Action of the complaint fail to state a claim against defendant United States Pictures, Inc. or defendant Milton Sperling, upon which relief can be granted.

Wherefore defendant United States Pictures, Inc. and defendant Milton Sperling demand that the First and Second Causes of Action of the complaint herein be dismissed and that they have their costs and disbursements in this action.

OLIVER B. SCHWAB and
ARTHUR LIVINGSTON,
/s/ By OLIVER B. SCHWAB,
Attorneys for Defendants United States Pictures, Inc. and Milton Sperling. [17]

[Endorsed]: Filed April 1, 1949.

[Title of District Court and Cause.]

ANSWER OF DEFENDANTS HARRY M. WARNER, JACK L. WARNER, AND WARNER BROS. PICTURES, INC.

Come now the defendants, Harry M. Warner, Jack L. Warner, and Warner Bros. Pictures, Inc., and answer the complaint herein as follows:

As to the Alleged First Cause of Action

1. Upon information and belief, deny each and every allegation contained in paragraphs 2, 12, 15, 19 and 25 of the complaint.

2. Deny having any knowledge or information sufficient to form a belief concerning the truth of any allegations contained in paragraphs 3, 4, and 20 of the complaint.

3. Deny each and every allegation in paragraph 10 of the complaint except that they admit that at

all the times mentioned in the complaint, Harry M. Warner and Jack L. Warner, together with their brother, Albert Warner, owned shares of the outstanding capital stock of Warner Bros. Pictures, Inc.

4. Deny each and every allegation contained in paragraphs [18] 11, 13, 21, 21(a), (b), (c), (d), (e), 22 and 23 of the complaint.

5. Upon information and belief deny each and every allegation contained in paragraph 14 of the complaint except that they admit that in or about September 1945, Warner Bros. Pictures, Inc. entered into an agreement with United States Pictures, Inc., to which agreement the Court is respectively referred for the true terms, provisions and conditions thereof.

6. Upon information and belief deny each and every allegation contained in paragraph 16 of the complaint, except that they admit that in or about November 1945, an agreement was entered into between Warner Bros. Pictures, Inc., United States Pictures, Inc., and The New York Trust Company, and respectfully refer the Court to said agreement for the true terms and conditions thereof.

7. Upon information and belief deny each and every allegation contained in paragraph 17 of the complaint, except that they admit that John E. Bierwirth, a Director of Warner Bros. Pictures, Inc., is and has been for several years President of the New York Trust Company, but deny having any knowledge or information concerning the exact period of his incumbency.

8. Upon information and belief, deny each and every allegation of paragraph 18 of the complaint, except that they admit that during the period commencing in or about April 1945, United States Pictures, Inc., has borrowed sums of money from The New York Trust Company, and admit that the agreements referred to in paragraph 5 and 6 of this answer have been in part performed and motion pictures are being produced and distributed under said agreements, and said agreements remain in part unperformed.

9. Upon information and belief deny each and every allegation contained in paragraph 24 of the complaint, except that they admit that plaintiff has made no demand. [19]

As to the Alleged Second Cause of Action.

10. Repeat each and every denial with respect to paragraphs 1 to and including 25 of the complaint as reincorporated in paragraph 26 thereof, with the same force and effect as if realleged in full herein.

11. Upon information and belief deny each and every allegation contained in paragraph 27 of the complaint.

As to the Alleged Third Cause of Action.

12. Repeat each and every denial with respect to paragraphs 1 to 10 inclusive, and 24 and 25 of the complaint as reincorporated in paragraph 28 thereof, with the same force and effect as if realleged in full herein.

13. Deny each and every allegation contained in paragraph 30 of the complaint, except that they admit that on or about December 8, 1942, William Goldman Theatres, Inc., engaged in business as a motion picture exhibitor in Philadelphia, Pa., brought suit in the United States District Court, for the Eastern District of Pennsylvania, against Warner Bros. Pictures, Inc., and certain of its subsidiaries, and certain other motion picture companies, which suit was entitled "William Goldman Theatres, Inc., vs. Loew's Inc., et al", and that the plaintiff therein sought an injunction and triple damages under the Anti-Trust Laws.

14. Deny each and every allegation contained in paragraph 31 of complaint except that they admit that in 1946 judgment for the plaintiff was rendered by the Court in the case entitled "William Goldman Theatres, Inc. vs. Loew's Inc., et al", that said judgment was affirmed by the Circuit Court of Appeals, Third Circuit on or about January 6th, 1948, and that certiorari was denied by the United States Supreme Court on or about May 3rd, 1948.

15. Deny each and every allegation contained in paragraphs 33 and 34 of the complaint, except that they admit that Warner Bros. [20] Pictures, Inc. and certain of its subsidiaries contributed a certain share of the money paid to William Goldman Theatres, Inc. and paid its own counsel fees and expenses incurred in the defense of the said action.

16. Deny each and every allegation in paragraphs 29, 35, 36, 37, 38, and 39 of the complaint.

As and for a Complete Defense to the Alleged First and Second Causes of Action, the Defendants Allege:

17. That each said cause of action stated in the complaint did not accrue within three years before the commencement of the action, and that said action is barred by the California Statute of Limitations.

As and for a Complete Defense to the Alleged Third Cause of Action, the Defendants Allege:

18. That the cause of action stated in the complaint did not accrue within three years before the commencement of the action and that said action is barred by the California Statute of Limitations.

As a Second Complete Defense to the Alleged Third Cause of Action, the Defendants Allege:

19. That the cause of action stated in the complaint did not accrue within six years before the commencement of the action and that said action is barred by the applicable Statute of Limitations of the State of Pennsylvania.

As and for a First Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

20. That each of said causes of action stated in the complaint did not accrue within three years before the commencement of the action and said action

is barred by the applicable Statute of Limitations of the State of New York. [21]

As and for a Second Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

21. That each said cause of action stated in the complaint did not accrue within three years before the commencement of the action, and that said action is barred by the applicable Statute of Limitations of the State of Delaware.

As and for a Third Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

22. That the complaint fails to comply with rule 23(b) of the Federal Rules of Civil Procedure and particularly the provision thereof which requires the complaint to set forth with particularity the efforts of the plaintiff to secure from the managing directors of the corporation and from the stockholders thereof such action as he desires and the reasons for his failure to obtain such action or the reason for not making such effort.

As and for a Fourth Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

23. That the complaint fails to state a claim against the defendants, upon which relief can be granted.

Wherefore, the defendants demand judgment that the complaint herein be dismissed with costs and disbursements of this action.

FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for Harry M. Warner, Jack L. Warner, Warner Bros. Pictures, Inc. [22]

Acknowledgment of Service attached. [23]

[Endorsed]: Filed April 4, 1949.

[Title of District Court and Cause.]

STIPULATION OF FACTS

The following Stipulation of Facts is entered into by and between all of the parties to the above entitled action, by and through their respective counsel, for the purposes of this action only, and upon the understanding that each party reserves the right to object to the relevancy, materiality, or competency of any of said facts, and upon the further understanding that said facts so stipulated are not all of the facts expected to be offered in evidence, and each party reserves the right to offer any part or parts of this Stipulation, and also such evidence as it desires in addition to the hereinafter stipulated facts and for the purpose of establishing or disproving any and all other facts in issue which are not stipulated: [24]

1. Plaintiff Edward S. Birn is now and at all times relevant to this proceeding has been a resi-

dent of the State of New York and is now and has been, since August 21, 1944, the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc., a Delaware Corporation hereinafter referred to as "Warner Bros.".

2. The following persons were directors of Warner Bros. during the period stated after their respective names: Harry M. Warner, 1923 to date; Jack L. Warner, 1923 to date; Albert Warner, 1923 to date; Waddill Catchings, 1925 to date; Morris Wolf, 1929 to date; Stanleigh P. Friedman, 1931 to date; Charles S. Guggenheimer, 1932 to date; Samuel Carlisle, 1934 to date; Robert W. Perkins, 1936 to date; Samuel Schneider, 1944 to date; Joseph Bernhard, 1936 to Sept. 10, 1945; John E. Bierwirth, Nov. 23, 1945, to date. During the period January 1, 1945, to September 10, 1945, the Board of Directors of Warner Bros. consisted of all the above named persons, except John E. Bierwirth; from September 10, 1945, to November 23, 1945, neither Joseph Bernhard nor John E. Bierwirth was a member of said Board. On and after November 23, 1945, to date, the Board of Directors of Warner Bros. consisted of all of the above named persons, except Joseph Bernhard.

3. During the year 1945 Harry M. Warner held 150,000 shares, Jack L. Warner held 208,800 shares, and their brother Albert Warner held 210,000 shares of the common capital stock of Warner Bros. There were outstanding during that time after deducting shares held in the Treasury about 3,701,-

090 shares of common stock. [25] During that time Harry M. Warner, Jack L. Warner, and Albert Warner owned approximately 15% of the issued and outstanding common stock, and thereafter continued to own approximately this percentage during all times relevant to these proceedings.

4. On August 4, 1945, United States Pictures, Inc., hereinafter called "United", was organized as a Delaware Corporation. On September 4, 1945, defendant Milton Sperling paid into United the sum of $12,500 and received 125 shares of its capital stock which were issued to him on September 6, 1945. On September 4, 1945, Joseph Bernhard paid into United the sum of $12,500 and received 125 shares of its capital stock which were issued to him on September 6, 1945. From September 6, 1945, to September 18, 1946, Milton Sperling and Joseph Bernhard each held 125 shares of capital stock of United and were, during such period of time, the holders of all of the issued and outstanding shares of United. On September 18, 1946, Milton Sperling acquired the 125 shares theretofore standing in the name of Joseph Bernhard. On December 23, 1946, said certificate for 125 shares was cancelled and a certificate for 63 of said shares was issued to Milton Sperling, which shares he has held since then (in addition to the 125 shares originally held by him), and 62 shares were issued to Title Insurance & Trust Co., Los Angeles, as trustee. The ownership of the issued and outstanding shares in United has remained the same from that date to the present time.

5. Warner Bros. and United entered into the following written agreements:

(a) Basic Agreement dated September 28, 1945;

(b) Amendment to Basic Agreement dated November 2, 1945;

(c) Amendment to Basic Agreement dated May 20, 1946;

(d) Supplement and Amendment to Basic Agreement dated December 6, 1947;

(e) Amendment to Basic and Supplemental Agreement dated [26] December 9, 1947;

(f) Amendment to Basic and Supplemental Agreement dated February 3, 1948;

(g) Amendment to Basic and Supplemental Agreement dated July 21, 1950.

There will be submitted to the Court photostat copies of each of these agreements which may be received by the Court with the same force and effect as if they were the original signed copies of these agreements. The officers signing each of the above documents were duly elected and qualified officers of the corporation on behalf of which each signed.

6. United, Warner Bros., and the New York Trust Co., a New York banking corporation, entered into the following written agreements in which each of the three was a party thereto:

Agreement dated October 31, 1945:

Agreement dated July 20, 1946, amending in part the agreement of October 31, 1945:

Amendment dated February 25, 1948, to agreement dated October 31, 1945.

Photostat copies of these agreements will be pre-

sented to the Court and may be received by the Court with the same force and effect as if they were original signed copies of these agreements. The officers signing each of the above documents were duly elected and qualified officers of the corporation on behalf of which each signed.

7. The following agreements between United and Warner Bros. were approved by the Board of Directors of Warner Bros.:

The Basic Agreement dated September 28, 1945;

The Amendment thereto dated November 2, 1945;

The Amendment to the Basic Agreement dated May 20, 1946;

The Amendment to the Basic Agreement dated December 6, 1947;

The Amendment to the Basic Agreement dated July 21, 1950. [27]

There will be submitted to the Court copies of portions of Minutes of the Board of Directors' meetings of Warner Bros. held September 25, 1945, September 28, 1945, November 23, 1945, June 18, 1946, and August 17, 1950, which may be received by the Court with the same force and effect as if they were originals. Other than above referred to there are no minutes of directors' meetings of defendant Warner Bros. Pictures, Inc., for the period January 1, 1945, to date, pertaining to agreements, relations and understandings between Warner Bros. Pictures, Inc., and United States Pictures, Inc.

8. That on or about January 10, 1946, and prior to the annual stockholders' meeting of Warner

Bros., held on February 19, 1946, there was mailed to each and every stockholder of record of Warner Bros. a notice of said meeting accompanied by a proxy statement, a form of proxy, and an annual report of said company dated August 31, 1945: That copies of said documents have been submitted to counsel for all parties, and copies thereof may be introduced without further identification or foundation.

There are no minutes of stockholders' meetings of defendant Warner Bros. for the period January 1, 1945, to February 27, 1950, pertaining to agreements, relations, and understandings between Warner Bros. Pictures, Inc., and United States Pictures, Inc.

9. There will be submitted to the Court copies of portions of Minutes of the Board of Directors' meetings of United held August 31, 1945, October 4, 1945, November 2, 1945, July 9, 1946, and stockholders' meetings held July 9, 1946, July 23, 1947, July 13, 1948, July 12, 1949, and July 11, 1950, which may be received by the Court with the same force and effect as if they were originals. Other than the above referred to, there are no minutes of Directors' meetings of defendant United for the period January 1, 1945, to date, pertaining to agreements, relations and understandings between Warner Bros. and United and no minutes [28] of stockholders' meetings of defendant United for the period January 1, 1945, to date, pertaining to agreements, relations and understandings between Warner Bros. and United.

10. On July 1, 1943, Warner Bros. entered into a loan agreement with the First National Bank of Boston, the New York Trust Co., Guarantee Trust Company of New York, Continental Illinois National Bank & Trust Company of Chicago, Pennsylvania Company for Insurance on Lives and Granting Annuities, the Union Trust Company of Pittsburgh, covering a loan of fifteen million dollars maturing in various amounts on various dates ending June 1, 1949. This loan was paid off in full by June 28, 1945. A photostat copy of this loan agreement will be presented to the Court, which may be received by the Court with the same force and effect as if it were an original, duly executed copy of said loan agreement.

As of June 28, 1945, Warner Bros. entered into another loan agreement, which loan agreement was incorporated in nine promissory notes of Warner Bros., all dated June 28, 1945, payable respectively to the following banks in the following amounts:

Banks	Amount
New York Trust Company	$ 2,297,297.00
Guaranty Trust Co.	3,445,946.00
First National Bank—Boston	2,756,757.00
Continental Illinois Nat. Bank	2,756,757.00
Union Trust Company Pittsburgh	2,756,757.00
The Pennsylvania Co., etc.	1,148,649.00
Bankers Trust Company—N. Y.	918,919.00
National City Bank—Cleveland	459,459.00
First National Bank—Minneapolis	459,459.00
	$17,000,000.00

All of said notes were in the same form except for the name of the payee banks and the amount of

the notes. There will be submitted to the Court, a photostat copy of one of the notes, to wit, the note payable to New York Trust Co., dated June 28, 1945, in the sum of $2,297,297.00 and such photostat may be received with the same force and effect as the original executed note. These notes were all paid off on August 29, 1945. [29]

On August 29, 1945, Warner Bros. entered into a further loan agreement, such loan agreement being incorporated in the promissory notes, for a new series of notes totaling $37,000,000.00, which were issued and delivered to the following banks in the following amounts:

Banks	Amount
New York Trust Co.—N. Y.	$ 5,000,000.00
Guaranty Trust Co.—N. Y.	7,500,000.00
First National Bank—Boston	6,000,000.00
Continental Ill. Nat. Bank—Chicago	6,000,000.00
Union Trust Co.—Pittsburgh	6,000,000.00
The Pennsylvania Co., etc.	2,500,000.00
Bankers Trust Company—N. Y.	2,000,000.00
National City Bank—Cleveland	1,000,000.00
First National Bank—Minneapolis	1,000,000.00
	$37,000,000.00

All of said notes were in the same form except the name of the payee banks and the amount of the notes. There will be submitted to the Court a photostat copy of the first of these notes, to wit, the one to New York Trust Co., in the sum of five million dollars, and said photostat may be received by the Court with the same force and effect as the original executed note. These notes were paid in full by December 10, 1945.

On December 10, 1945, a new series of notes, totaling $30,229,000.00, were issued and delivered by Warner Bros. to the following banks in the following amounts:

Banks	Amounts
New York Trust Co.—N. Y.	$ 4,085,000.00
Guaranty Trust Co.—N. Y.	6,127,500.00
First National Bank—Boston	4,902,000.00
Continental Ill. Nat. Bank—Chicago	4,902,000.00
Union Trust Co.—Pittsburgh	4,902,000.00
The Pennsylvania Co., etc.	2,042,500.00
Bankers Trust Co.—N. Y.	1,634,000.00
National City Bank—Cleveland	817,000.00
First National Bank—Minneapolis	817,000.00
	$30,229,000.00

All of the said notes were in the same form except the name of the payee banks and the amount of the notes. There may be received in evidence a photostat copy of the first of these [30] notes, to wit, the one to New York Trust Co., New York, in the sum of $4,085,000.00. Such photostat shall have the same force and effect as the original note. All of said notes were paid off in full by May 29, 1946.

On May 29, 1946, Warner Bros. made a new note issue aggregating $23,865,000.00, due serially to May 1, 1954, with the other terms and conditions thereof incorporated therein, to the following banks in the following amounts:

Banks	Amount
New York Trust Company—N. Y.	$ 3,225,000.00
Guaranty Trust Company—N. Y.	4,837,500.00
First National Bank—Boston	3,870,000.00
Continental National Bank—Chicago	3,870,000.00
Union Trust Company—Pittsburgh (Now Mellon National Bank & Trust Co.)	3,870,000.00

Pennsylvania Co., etc.	1,612,500.00
Bankers Trust Company	1,290,000.00
National City Bank—Cleveland	645,000.00
First National Bank—Minneapolis	645,000.00
	$23,865,000.00

All of said notes were in the same form except the name of the payee banks and the amount of the notes. There may be received in evidence a photostat copy of the first of these notes, to wit, the note to The New York Trust Co., New York, in the sum of $3,225,000.00. These notes were as of November 23, 1949, outstanding except as reduced by payments on account.

Dated: June 15, 1951.

MOSS, LYON & DUNN,
/s/ By CHARLES B. SMITH,
Attorneys for Plaintiff.

FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for Harry M. Warner, Jack L. Warner, and Warner Bros. Pictures, Inc.

OLIVER B. SCHWAB and
ARTHUR LIVINGSTON,
/s/ By ARTHUR LIVINGSTON,
Attorneys for Milton Sperling and United States Pictures, Inc. [31]

[Endorsed]: Filed June 18, 1951.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR LEAVE TO FILE AMENDED AND SUPPLEMENTAL COMPLAINT

To the Defendants, Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc., and to Their Attorneys, Freston & Files and Eugene D. Williams; to the Defendants, Milton Sperling and United States Pictures, Inc., and to Their Attorneys, Oliver B. Schwab and Arthur Livingston:

You and Each of You Will Please Take Notice that on Tuesday, March 17, 1953, at 10:00 a.m. of said day or as soon thereafter as counsel can be heard at the courtroom of the Honorable William Mathes located in the Federal Courthouse, Los Angeles, California, plaintiff Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, deceased, will move the court for leave to file an amended and supplemental complaint in the above entitled action. [32]

Said motion will be made upon the grounds that an amended and supplemental complaint is necessary in the interests of justice and to set forth matters occurring subsequent to the filing of the original complaint.

Said motion will be based on this notice, Memorandum of Points and Authorities, the proposed amended and supplemental complaint, a copy of which is served herewith and the papers, files, rec-

ords and minutes of the court in the within action.

Dated: March 13, 1953.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff. [33]

[Title of District Court and Cause.]

AMENDED AND SUPPLEMENTAL COMPLAINT (AFTER SEVERANCE OF THIRD CAUSE OF ACTION) FOR ACCOUNTING AND DAMAGES

Plaintiff Edward S. Birn having sued herein derivatively on behalf and for the benefit of defendant Warner Bros. Pictures, Inc., and the stockholders thereof, and upon his death the special administrator of his estate in California having, by order of this court, been duly substituted as party plaintiff, and plaintiff having first obtained leave of the courts so to do, now files this amended and supplemental complaint as follows: (All of the allegations below being upon information and belief except allegations "1" to "4", inclusive, and allegation "22" which are alleged as of plaintiff's knowledge.

For a First Cause of Action Against All Defendants.

1. Jurisdiction herein is founded on diversity of citizenship and amount. This action is not a collu-

sive one to confer on [34] this court jurisdiction of an action over which it would not otherwise have jurisdiction.

2. The matter in controversy exceeds, exclusive of interest and costs, the sum of $3,000.

3. Plaintiff's decedent was a citizen of the State of New York, and the estate of said decedent is in the course of probate in said state.

4. Plaintiff's decedent was during the time that the transactions herein complained of occurred, the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc., having owned said stock since August 21, 1944.

5. Defendants Warner Bros. Pictures, Inc., (hereinafter referred to as Warner Bros.) and United States Pictures, Inc., (hereinafter referred to as United) are corporations incorporated under the laws of the State of Delaware, engaged in the motion picture business and said corporations do business and maintain offices in the County of Los Angeles and State of California.

6. The defendants Milton Sperling, Harry M. Warner and Jack L. Warner are citizens of the State of California.

7. That during the time that the transactions hereinbelow complained of occurred, the defendants, Harry M. Warner and Jack L. Warner, were directors of Warner Bros.

8. That the following persons were directors of Warner Bros. during the periods stated after their respective names:

Harry M. Warner, 1923 to date; Jack L. Warner,

1923 to date; Albert Warner, 1923 to date; Waddill Catchings, 1925 to date; Morris Wolf, 1926 to date; Stanleigh P. Friedman, 1931 to date; Charles S. Guggenheimer, 1932 to date; Samuel Carlisle, 1934 to date; [35] Robert W. Perkins, 1936 to date; Samuel Schneider, 1944 to date; Joseph Bernhard, 1936 to September 10, 1950; John E. Bierwirth, November, 1945 to date.

9. That the aforementioned Harry M. Warner, Jack L. Warner and Albert Warner are brothers and the aforesaid Milton Sperling is the son-in-law of Harry M. Warner.

10. That at all times herein mentioned the defendants Harry M. Warner and Jack L. Warner, together with their brother Albert Warner owned a large and controlling block of the outstanding capital stock of Warner Bros. and said three brothers did control and dominate Warner Bros. and did actively direct its supervision, policies, actions and business including the acts hereinafter alleged in this complaint and did actually select, dominate and control the directors and officers of Warner Bros.

11. That in or about or prior to the summer of 1945 the individual defendants did illegally, wrongfully and in bad faith, conspire and act together and did conspire and still continue to conspire to waste, mismanage, divert and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling and United at the expense of Warner Bros. and regardless of the con-

sequences to Warner Bros. and each of the different things and acts done and being done by said individual defendants, and by the corporate defendants through their directors and officers, hereinbelow alleged, were, among others, and continue to be all steps in said conspiracy and were and are being committed pursuant thereto, and in furtherance of said objects. That in performing such acts and doing such things, defendants acted and continue to act unfairly to Warner Bros. and for the benefit of and advantage to United and Sperling; and the defendants Harry Warner and Jack Warner were and continue to be unfair and disloyal to their trust as directors and executive [36] officers of Warner Bros.

12. That on or about August 6, 1945, defendant United was caused to be organized with nominal capital contributions and the capital stock of said corporation was issued to Sperling and Joseph Bernhard, a Warner director who thereafter resigned from the Warner Board, severed his connection with Warner, and received $78,000 in the form of "severance pay", though his employment contract with Warner contained no provision entitling Bernhard to severance pay. That since September 1946, defendant Sperling has been the sole stockholder of defendant United, with the exception of 62 shares of which he later assigned to the Title Insurance and Trust Company of Los Angeles to be held in trust for the benefit of his minor children.

13. That said corporation was organized in order that, through it, the defendant Sperling might

wrongfully utilize and divert from Warner Bros. the funds, credits, facilities, assets and business opportunities of Warner for his private purpose and benefits to the disadvantage and detriment of Warner Bros.

14. In or about September, 1945, the defendants caused Warner Bros. and United to enter into an agreement, hereinafter referred to as the "basic agreement", which provided in substance as follows:

Six motion pictures were to be produced by United at the studio, and with the facilities and personnel of, Warner Bros. Said pictures were to be distributed by Warner Bros. through its subsidiaries, the latter to retain out of the gross proceeds of distribution certain percentages and sums as fees and expenses of distribution and the net profits from the production and distribution of said pictures were to be shared equally between Warner Bros. and United.

Warner Bros. was to advance 50% of the cost of production of said pictures and the remaining 50% of said cost was to be [37] advanced by United. In this latter connection, however, United was authorized to borrow its entire share of the cost of production and was further authorized to pledge, as security for such borrowing, the pictures to be produced, including the negatives and positive prints thereof and including the entire net proceeds of the distribution of said pictures, and Warner Bros. was to agree to such pledge and thereby subordinate its investment and provide with its funds the collateral security for the loan to United.

15. That at the time of the making of said agreement, it was intended by defendants that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of said six motion pictures by means of the borrowing privileges set forth in said agreement.

16. The defendants caused amendments to the basic agreement to be entered into between Warner Bros. and United. These amendments were dated November 2, 1945, May 20, 1946, December 6, 1947, December 9, 1947, July 21, 1950, and August 12, 1952. The amendments bearing date December 6, 1947, July 21, 1950 and August 12, 1952, provided, among other things, that Warner Bros. would advance 100% of the cost of a further series of motion pictures called "additional" pictures; that United would produce such additional pictures in the Warner studios; that in the production of such additional pictures, United would not be called upon to advance any of its own funds; that with respect to any picture produced by United after December 6, 1947, United would not be called upon to declare whether the same is being produced by it under the basic contract, unamended or whether it is being produced under the provisions of the said amendments, until the commencement of principal photography thereon.

17. That in furtherance of said basic agreement and intention as set forth in the preceding paragraphs and in or about [38] November, 1945, the

defendants caused an agreement to be entered into between Warner Bros. and United and The New York Trust Company (the latter being a New York banking corporation) for the loan by The New York Trust Company to United, of the latter's share of the cost of production of the pictures as aforesaid and under said agreement there was pledged as security for the repayment of said loans the security described in allegation "14" hereinabove and said basic agreement further provided that after said loans had been repaid and after the share of the production costs of the pictures advanced by Warner Bros. had likewise been repaid, the net profits resulting from the pictures were to be shared equally between Warner Bros. and United.

18. That said loan agreement was effectuated through the use of the valuable credit and banking facilities and connections of Warner Bros. in that John E. Bierwirth, a director of Warner Bros., is and has been president of The New York Trust Company since 1941, and his influence was used by Warner Bros. and Joseph Bernhard to effect said loan agreement, and further, in that Warner Bros. is a valued customer of The New York Trust Company and its patronage is favorably sought for various reasons including the fact that Warner Bros. was then indebted to a syndicate of banks, including The New York Trust Company, to the extent of several million dollars.

19. That in pursuance of said agreements as allegated in paragraphs numbered "14", "16" and "17" above, and during the period commencing in

or about November, 1945, to date, United has borrowed large sums from The New York Trust Company and the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being used by United, and the said agreements have been in part performed and motion pictures are being produced and distributed under said agreements and said agreements remain in part unperformed. [39]

20. That in connection with the performance of said agreements, United has not advanced any of its private funds or capital and has contributed to the costs of production of said pictures solely out of loans from The New York Trust Company.

21. Defendants have designed and contrived to cause said agreements between Warner Bros. and United to be performed in a manner unfair to Warner Bros. and to benefit and to further the interests of United and Sperling at the expense and to the detriment of Warner Bros. That said agreements have not been made, performed and administered as "arms length" transactions between Warner Bros. and United.

22. That plaintiff's decedent did not discover the facts set forth in allegations "11" to "21" inclusive, until October of 1948 and plaintiff's decedent had no notice or information of circumstances which would put him on inquiry regarding such facts until October of 1948. The causes of action herein allegated have been continuous from 1945 to date hereof.

23. That by reason of the premises, Warner

Bros. has suffered and still suffers improper and illegal waste, mismanagement, misappropriation and diversion of its valuable assets, credits, facilities and business opportunities all to its loss and to the improper and personal profit and benefit of United and Sperling, in that:

(a) The aforesaid agreements, the manner in which the same have been and are being performed and administered are grossly unfair to Warner Bros.; the amount of return or profit provided thereunder to Warner Bros. and the amount of distribution fees provided thereunder to its subsidiaries are grossly unreasonable and unfair to Warner Bros.; they are not in accordance with customary agreements in the motion picture industry; and (b) Warner Bros., in effect, has been and still is [40] providing the use of its funds, credits, facilities and assets to defendant United without any adequate, reasonable or legal consideration, return, or payment to Warner Bros.; and

(c) Warner Bros. in effect, has been and still is undertaking the sole risk of capital and bearing the entire burden of the cost of production of said motion pictures involved in the aforesaid agreement, and in the event of loss in said productions, Warner Bros. will suffer the entire or principal amount thereof inasmuch as United has advanced no capital and is financially unable to meet or share any substantial losses; and despite the foregoing, Warner Bros, receives only 50% of the net profits and the other 50% of the said profits goes to United and in addition thereto, the defendant

Sperling is assured a substantial annual salary which becomes part of the production costs of said pictures; such profit divisions are grossly unfair to Warner Bros. and the receipt by United of said profits and benefits or the receipt of said benefits by Sperling under said agreements constitutes an improper and unconscionable gift or advantage to United and to Sperling at the expense of Warner Bros.; and

(d) The subordination and use of the capital assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes an improper or illegal use of property of Warner Bros. for which the latter receives in return no legal, adequate or fair consideration; and

(e) The subordination and use of the capital, assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes a breach of the existing written agreement between Warner [41] Bros. and a syndicate of banks under which Warner Bros. is the recipient of large business loans totalling several millions of dollars, and the said last named written agreement with said banks prohibits such use of the capital and assets of Warner Bros., and thereby Warner Bros. is endangering said loans and injuring its credit.

24. That all of the acts and matters alleged in this complaint were then known or with the exercise of reasonable diligence should have been then known to the defendants, and all of the defendants

either actively participated in said acts or matters or with knowledge of the same and the course of conduct being pursued, ratified said acts or matters or failed to take any corrective measures.

25. That by reason of the premises, the defendant United and its assets, and the profits and benefits derived by it from Warner Bros. under the above mentioned agreements, are substantially based, upon, result from, and stand in the place of, the assets and business opportunities wrongfully diverted from Warner Bros. to United and hence the capital stock of United and all of its said assets belonging in equity and good conscience to Warner Bros.

26. Demand upon the directors of Warner Bros. to institute this action would be futile and plaintiff had made no such demand because all or a majority of the present Board of Directors and officers of said corporation wrongfully participated in the acts and grievances herein complained of and said Board of Directors is controlled by the active wrongdoers herein, and since those to whom application would have to be made to institute this suit are the same persons who wrongfully caused or permitted the grievances herein complained of, such persons would refuse to bring suit against themselves and in fact would be disqualified from faithfully doing so.

27. Plaintiff's decedent has made no demand upon the [42] stockholders of Warner Bros. because under the laws of Delaware the management of Warner Bros. is directed by its Board of Directors

and the stockholders cannot bring suit for Warner Bros., nor require the Board of Directors to bring such suit; and further because the defendants Jack L. Warner and Harry M. Warner and their brother Albert Warner hold upwards of sixteen per cent (16%) of the total issued stock of Warner Bros. and the balance of such stock is held by upwards of thirty thousand (30,000) stockholders widely scattered over the United States and foreign countries, so that such demand would entail a prohibitive cost and expense to the plaintiff while the management of Warner Bros. could and would defend its position by the use of its corporate funds and facilities which management is dominated and controlled by the wrongdoers herein.

28. Plaintiff has no adequate remedy at law and he and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted.

For a Second Cause of Action Against All Defendants Except United and Sperling.

29. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "28" (except ("11"), inclusive, with the same force and effect as though herein alleged.

30. That by reason of the acts committed by these defendants as herein alleged, the individual defendants, while acting in their fiduciary capacities and while charged with their fiduciary duties as direc-

tors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, nonfeasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

Wherefore, plaintiff demands judgment as follows: [43]

(1) That the defendants account to Warner Bros. for all losses and damages suffered by it and for all profits and benefits received by said defendants, and that defendants make restitution accordingly.

(2) That a trust be impressed upon the capital stock and assets of United in favor of Warner Bros.

(3) That the agreement between Warner Bros. and United to the extent that the same is unexecuted and to the extent that it is practicable to do so, should be cancelled and terminated.

(4) That defendants Harry M. Warner and Jack L. Warner make whole Warner Bros. Pictures, Inc. for all damages that it has suffered because of such defendants' successive breaches of their fiduciary duty to Warner Bros. Pictures, Inc., or arising out of the same, and because of their illegal and wrongful acts herein alleged.

(5) That plaintiff be allowed the costs, disbursements and expenses of this action, including reasonable counsel and accountants fees.

(6) That such other and further relief be granted as shall be equitable in the premises.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
By HERMAN H. LEVY,
Attorneys for Plaintiff. [44]

Duly Verified. [45]

Affidavit of Service by Mail attached. [46]

[Endorsed]: Filed March 13, 1953.

[Title of District Court and Cause.]

ORDER DENYING MOTION FOR LEAVE TO FILE AMENDED AND SUPPLEMENTAL COMPLAINT

The above-entitled matter came on regularly before the undersigned William C. Mathes, District Judge, at his courtroom in Los Angeles, California, on March 17, 1953, at 10 o'clock a.m., plaintiff being represented by Messrs. Moss, Lyon and Dunn and Herman H. Levy, his attorneys, the defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. being represented by their attorneys, Messrs. Freston & Files and Eugene D. Williams, and the defendants Milton Sperling and United States Pictures, Inc. being represented by their attorney, Oliver B. Schwab:

Motion for leave to file an amended and supplemental complaint was made on behalf of the plaintiff, written objections were filed by the defendants Warner; above-named, and oral objections were

made by the defendants Milton Sperling and United States [52] Pictures, Inc., above-named; the matter was argued and submitted to the Court, and the Court having duly considered said motion and the objections thereto and the arguments of counsel:

It Is Ordered that said motion for leave to file amended and supplemental complaint be, and the same is, hereby denied; without prejudice, however, to the plaintiff making a motion at an appropriate time for leave to amend to conform to the proof as permitted by Rule 15(b) of the Rules of Civil Procedure.

Done in open court March 17, 1953.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner.

Approved as to form this 18th day of March, 1953.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.
OLIVER B. SCHWAB,
/s/ By OLIVER B. SCHWAB,
Attorney for Defendants Milton Sperling and United States Pictures, Inc.

[Endorsed]: Filed March 23, 1953.

[Title of District Court and Cause.]

STIPULATION CONCERNING OTHER STOCKHOLDERS' CASES

It Is Stipulated that the following is the status of the cases filed in New York which involve generally the set of facts involved in the above action:

Pending in the United States District Court, Southern District of New York: [54]

William B. Weinberger vs. Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed September 24, 1948, case dismissed December 31, 1951, but can be restored upon ten days' notice.

Anna Kassner vs. United States Pictures, Inc., Warner Bros. Pictures, Inc., Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner and Morris Wolf, complaint filed September 30, 1948, action dismissed upon stipulation January 11, 1951.

Irving W. Mencher vs. Harry M. Warner, Jack L. Warner, Milton Sperling, Robert W. Perkins, Morris Wolf, Joseph Bernhard, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed October 5, 1948, case dismissed upon stipulation January 11, 1951.

Annie Fastenberg vs. Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Morris Wolf, United States Pic-

tures, Inc., and Warner Bros. Pictures, Inc., complaint filed October 7, 1948, action dismissed upon stipulation January 12, 1951.

Kate Lavine vs. Robert W. Perkins, Harry M. Warner, Joseph Bernhard, Jack L. Warner, Milton Sperling, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed October 11, 1948, dismissed for lack of prosecution by order of Judge Knox, June 19, 1950.

Edward S. Birn vs. Milton Sperling, Joseph Bernhard, Harry M. Warner, Jack L. Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed November 12, 1948, dismissed by order of Judge Alfred C. Coxe, January 19, 1951, upon ground that case had abated under Rule 1 of Court Rules.

Bernard M. Geller vs. Jack L. Warner, Milton Sperling, Morris Wolf, Harry M. Warner, Robert W. Perkins, Joseph Bernhard, [55] United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed December 10, 1948, action dismissed upon stipulation January 18, 1951.

Abraham Fistel vs. John E. Bierwirth, Samuel Schneider, Samuel Carlisle, Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Albert Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed January 27, 1949, dismissed without prejudice June 18, 1953.

Lawrence B. Dottenheim vs. Milton Sperling,

Harry M. Warner, Jack L. Warner, Joseph Bernhard, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed March 9, 1949, case removed from calendar and from pre-trial calendar November 17, 1952, but can be restored on ten days' notice.

Filed in the Supreme Court of New York County, New York:

William B. Weinberger vs. John E. Bierwirth, Samuel Carlisle, Waddill Catchings, Stanleigh P. Friedman, Charles S. Guggenheimer, Samuel Schneider, Albert Warner, and Warner Bros. Pictures, Inc., commenced September 28, 1948 as to Catchings; October 7, 1948 as to Carlisle and Warner Bros. Pictures, Inc.; October 11, 1948, as to Schneider; October 18, 1948 as to Albert Warner; October 29, 1948 as to Friedman. Order for bond in sum of $50,000 has not been complied with and action stayed. Case not on calendar.

Anne Goodfriend vs: Jack L. Warner, Milton Sperling, Morris Wolf, Harry M. Warner, Robert W. Perkins, Joseph Bernhard, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 8, 1948, by service on Warner Bros. Pictures, Inc., and on January 10, 1949, as against Robert W. Perkins. Order for security in sum of $25,000 granted, and extending time to answer has not been complied with; case not on calendar.

William B. Weinberger vs. Milton Sperling, Jo-

seph Bernhard, [56] United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 20, 1948 by service on Warner Bros. Pictures, Inc., order for security bond in sum of $25,000 and extending time to answer not complied with; case not on calendar.

Annie Fastenberg vs. Joseph Bernhard, Milton Sperling, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 21, 1948 by service on Warner Bros. Pictures, Inc. of summons without complaint. Complaint has never been served and action is not on calendar.

Anna Kassner vs. Joseph Bernhard, Milton Sperling, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 21, 1948 by service on Warner Bros. Pictures, Inc., order for bond in sum of $25,000 and extending time to answer has not been complied with; case not on calendar.

Irving W. Mencher vs. Milton Sperling, Joseph Bernhard, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced January 3, 1949 by service on Warner Bros. Pictures, Inc., order for bond in sum of $25,000 and extending time to answer not complied with; case not on calendar.

Harry Rattner vs. John E. Bierwirth, Samuel Schneider, Samuel Carlisle, Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Albert Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros.

Pictures, Inc., commenced February 25, 1950 by service on Warner Bros. Pictures, Inc.; March 1, 1950, as to Carlisle; March 14, 1950, as to Bierwirth. Order for security bond in the sum of $75,000 has not been complied with; case not on calendar.

Abraham Fistel vs. John E. Bierwirth, Samuel Schneider, Samuel Carlisle, Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Albert Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., action commenced March 2, 1950, against Warner Bros. Pictures, and on [57] April 26, 1950, against Bernhard. Answer for Warner Bros. Pictures, Inc. served June 21, 1950. Amended answer on July 13, 1950. Case is not on calendar.

Lawrence B. Dottenheim vs. Milton Sperling, Joseph Bernhard, Albert Warner, Harry M. Warner, Morris Wolf, Robert W. Perkins, Samuel Schneider, Samuel Carlisle, Waddill Catchings, Stanleigh P. Friedman, Charles S. Guggenheimer, John E. Bierwirth, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced as against Sperling March 22, 1950; as against Guggenheimer June 16, 1950; as against Catchings June 27, 1950; as against Bierwirth June 27, 1950; as against Warner Bros. Pictures, Inc. December 6, 1950. Answer served by Sperling on June 14, 1950; by Guggenheimer on July 7, 1950; by Catchings and Bierwirth on July 17, 1950; by Warner Bros. Pictures, Inc. on December 27,

1950. Motion to traverse service as to United States Pictures, Inc., referred to Referee. Case has not been placed on calendar.

Dated: July 3, 1953.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.

/s/ OLIVER B. SCHWAB,
Attorney for the Defendants Milton Sperling and United States Pictures, Inc.

FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for Warner
Defendants. [58]

[Endorsed]: Filed July 14, 1953.

[Title of District Court and Cause.]

PLAINTIFF'S OBJECTIONS TO FINDINGS OF FACT AND CONCLUSIONS OF LAW

Comes Now the plaintiff and files his objections to the proposed Findings of Fact and Conclusions of Law as prepared by counsel for the defendants and files herewith his Statement of Objections to such Findings of Fact and Conclusions of Law and reasons therefor, as follows:

I.

Objection to Proposed Finding No. III.

Plaintiff objects to that portion of proposed finding No. III (page 3, lines 3-7) viz:

> "That this action was commenced by Edward S. Birn as the owner of four hundred shares of the capital stock of the defendant Warner Bros. Pictures, Inc., and that he is suing derivatively on behalf of and for the benefit [135] of said defendant Warner Bros. Pictures, Inc., and the stockholders thereof;"

on the ground that this finding fails to incorporate a finding to the effect that Birn owned 400 shares during the period complained of.

Plaintiff objects to this finding on the ground that it is incomplete in that it omits to make a finding as to what constitutes the "principal purpose of the suit" (see Opinion of the Court, page 51, in which the Court says: "The 'matter in controversy' referred to in 28 U.S.C. Sec. 1332 must be ascertained from the 'principal purpose of the suit'.") And plaintiff requests that the following be added (beginning on line 7 of page 3 following the word "thereof"):

"The principal purpose of the suit was to obtain judicial scrutiny of the facts involved in the negotiation, execution and performance of a contract, and a series of three amendments which had been entered into by the corporate defendants prior to the filing of the suit; under the terms of which agreements the Warner corporation, a publicly owned company headed by Harry Warner as Presi-

dent, had participated in a series of profit-sharing transactions with United, a company which was formed for the purpose of engaging in these transactions and whose stock was owned by members of Harry Warner's family, to-wit: during the first year of United's existence, its stock was owned by defendant Sperling and one Joseph Bernhard, a former officer and director of the Warner corporation; thereafter, and at the time of the filing of the suit, it was owned by Sperling and his two infant children who are Harry Warner's grandchildren; with a view:

(a) to adjudicating the merits of plaintiff stockholder's claim which is substantially:

1. Self-dealing and overreaching to favor members of Harry Warner's family, permeated the formation of United and the negotiation, execution and performance of said agreements;

2. The terms of the contract and of the amendments were unfair to the Warner corporation; they were unwarrantedly favorable to United and Sperling and were performed in a manner unwarrantedly favorable to United and Sperling and unfair to the Warner corporation.

3. Throughout the Warner corporation's participation with United in those profit-sharing transactions, Harry and Jack Warner together with their brother Albert Warner actively directed the supervision, policies, acts and business of the Warner corporation;

4. Negotiations which were not conducted at "arms length", designed and channeled by Harry

Warner to unwarrantedly favor United and Sperling at Warner corporation's expense, with Harry Warner actively participating therein, preceded the formation of United and the drawing and signing of the contracts and the amendments;

5. Harry and Jack Warner with intent to favor Sperling; to further and enrich Sperling's private interests at Warner corporation's expense, suffered and countenanced the contract and the amendments, to contain terms unfair to the Warner corporation; and to be performed in a manner unwarrantedly favorable to United and Sperling and unfair to the Warner corporation; and furthermore, in a manner contrary to the terms of the agreements;

6. With like intent, Harry and Jack Warner, recommended that the Warner Board approve the contract (it is hereinafter referred to as the master contract) and following such recommendation, obtained the Board's approval; [137]

7. The suit was commenced on December 15, 1948; one of the amendments was signed by the corporate defendants on December 6, 1947; Harry and Jack Warner negotiated the terms of this amendment and caused the Warner corporation to sign it; the amendment materially altered the terms of the master contract; as altered, the terms of the amendment were increasingly unfair to the Warner corporation and unwarrantedly favorable to United and Sperling and one of the profit-sharing transactions, namely, the production and distribution of a picture entitled "South of St. Louis" was par-

ticipated in by the corporate defendants on the terms set forth in this amendment;

8. Neither before this amendment was signed by the Warner corporation nor during such production and distribution and up to the filing of the suit, had Harry and Jack Warner sought nor obtained the Warner Board's approval thereof or authorization to cause it to be signed.

9. At the time this amendment was signed and during the nine months which preceded its signing and at the time this suit was filed, Harry Warner individually, had a financial interest in United, to-wit: United had theretofore borrowed $150,000 from a bank; had executed a demand promissory note payable to the bank in that sum; Harry Warner had endorsed the note and the loan was then unpaid;

10. At the time that this amendment was signed and for more than one year before, and at the time this suit was filed, Harry Warner's daughter, Betty Sperling, was financially interested in United, to-wit: In September of 1946, Sperling purchased Bernhard's stock interest [138] in United for $400,000 in cash and thereby became the owner of all of United's outstanding stock; Sperling borrowed this money from the same bank and deposited as collateral, securities owned by Betty Sperling; on December 6, 1947, the loan was unpaid and the collateral was still in the possession of the bank;

11. At the time that this amendment was signed

and for approximately one year before, Harry Warner's grandchildren, being the children of Betty and Milton Sperling, had a financial interest in United, to-wit: In December of 1946, Sperling transferred 62 shares of United stock to Title Insurance & Trust Company, a California corporation, as Trustee for the benefit of his children, and Harry Warner knew of such interest when this amendment was signed.

12. Before the master contract was signed by the corporate defendants, Joseph Bernhard was a resident of New York State and was an officer, director in and was employed by the Warner corporation under a written contract of employment; in negotiations which preceded the drawing and signing of the master contract, it was arranged between Harry Warner and Bernhard that Bernhard form United; that he and Sperling own its stock; that Bernhard's contract of employment with the Warner corporation be terminated; that Bernhard resign as an officer and director; that Warner corporation grant him $78,000 as "severance pay", although his employment contract contained no provision obligating the Warner corporation to make such payment.

13. That three days before the master contract was signed, the Warner Board of Directors unlawfully authorized a grant to Bernhard of $78,000, and unlawfully paid him [139] $78,000.

14. That neither the master contract nor any of the amendments, nor the $78,000 grant to Bern-

hard was submitted to the stockholders of the Warner corporation for their approval; accordingly, the contract, the amendments and the payment to Bernhard were not approved by the stockholders.

15. Harry and Jack Warner, together with their brother Albert Warner, dominated and controlled the Warner Board; they selected, dominated and controlled the other directors on the Board.

16. That the Warner corporation has suffered and will suffer injury and damage as a result of the company's participation in these transactions.

17. It would have been futile for the plaintiff stockholder to demand of the Warner corporation and its directors that they act to remedy the wrongs asserted in plaintiff stockholder's claim; to institute this suit and obtain relief which to the court may seem just. Had the plaintiff addressed such demand to the corporation and its directors, they would have refused to act thereon.

18. Plaintiff stockholder did not address such demand to the stockholders of the Warner corporation for the reason that the stockholders number some 30,000; they are located in various states of the United States and in foreign countries all over the world; and it would accordingly be virtually impossible and impractical to obtain concerted action by the stockholders.

19. Plaintiff did not collude with defendants, or any of them, for the purpose of creating a case cognizable by this Court. [140]

II.

Objection to Proposed Finding No. IV.

Plaintiff objects to that portion of finding No. IV (page 3, lines 25-30), viz;

> "that the contract in controversy and all amendments and supplements thereto were and are sound business arrangements made and entered into in good faith and without fraud, and said contract and amendments and supplements thereto were of benefit to Warner Bros. Pictures, Inc. and its stockholders,"

on the ground that it purports to adjudicate that the master contract and all its amendments and supplements, viz: those executed and negotiated before and after the commencement of the suit, were in all respects legal and fair to the Warner corporation and were performed in a manner fair to said company and resulted in benefit to said company.

The Court's written opinion (page 54) contains no language which indicates, in words or substance, that the Court has adjudicated issues bearing on the legality or illegality of the master contract or amendments and supplements thereto; the fairness or unfairness to the Warner corporation thereof; the fairness or unfairness to the Warner corporation of the manner in which the contract or its amendments were performed or whether or not the Warner corporation suffered and countenanced breaches thereof by United; and whether the Warner corporation benefited or was injured.

Plaintiff objects to that portion of finding No. IV, (page 3, lines 30-32 and page 4, lines 1-5), viz:

> "said contract and said amendments and supplements thereto were considered by said eleven members of the Board of Directors of Warner Bros. Pictures, Inc. to be a sound business arrangement for the best present and future interests of the corporation; that in approving [141] and authorizing the contract and said amendments and supplements thereto, the officers and Board of Directors acted in good faith and exercised their independent business judgment."

on the grounds (a) that the presence or absence of jurisdiction of the subject matter is determined by the factual situation at the time of the filing of the suit; that embraced in this portion of the proposed finding are amendments and supplements to the master contract entered into after suit was commenced, namely, the amendment dated July 21, 1950, (Exhibit 7 in evidence), and the amendment dated August 12, 1952, (Exhibit 107, last page, in evidence); (b) the amendment to the master contract dated December 6, 1947, was not presented to any meeting of the Warner Board nor did said agreement receive the Board's approval at any time before the suit was filed. Following a meeting of the Warner Board held on June 18, 1945, there was no meeting of the Board at which any matter concerning Warner-United relations was taken up or presented for Board consideration until August 17, 1950, or some two years after the suit was filed. (see

Stipulation of Facts, June 15, 1951, page 5, Section 7); (c) that this portion of the proposed finding does not conform to the first finding contained on page 54 of the Court's opinion, in that the purport of the Court's finding is that the Warner Board of Directors, as a Board, considered the contract in controversy to be a sound business arrangement for the best present and future interests of the corporation. The purport of the proposed finding is and connotes that every individual director, including the brothers Warner, believed the contract in controversy, and all amendments and supplements thereto, to be fair to the Warner corporation.

Plaintiff further objects to that portion of finding No. IV, (page 4, lines 2-5) viz:

> "that in approving and authorizing the contract and said amendments and supplements thereto, the officers and Board of Directors acted in good faith and exercised their independent business judgment."

on the grounds: (a) that as hereinabove pointed out, the above quoted portion does not conform to the Court's Opinion (page 54) in that the purport of the Court's finding is, that in approving and authorizing the master contract and such amendments thereto as were actually presented for Board approval in regular or special Board meetings, those members of the Board who voted to approve and authorize such contracts and such amendments—other than the three Warner brothers who were alleged to have dominated and controlled them—believed in good faith that the documents which they

approved and authorized were sound business arrangements for the best future interests of the corporation and they exercised their individual judgment in accordance with such belief.

The purport of the proposed finding is and connotes that not only did those directors so believe and in good faith exercise their independent judgment in accordance therewith, but that the three Warner brothers as well, so believed and were virtuous and sincere in that belief.

Plaintiff objects to that portion of proposed finding No. IV (page 4, lines 5-8) viz:

> "That at the time of the execution of the contract, Albert Warner, together with the defendants Harry M. Warner and Jack L. Warner, owned only about fifteen per cent of the outstanding shares of stock of Warner Bros. Pictures, Inc.,"

on the ground that it fails to conform to the Court's Opinion (page 54) in that the figure fixed therein is "less than 20%".

Plaintiff objects to that portion of proposed finding No. IV (page 4, lines 11-13), viz:

> "That neither the stockholders, its officers or [143] directors were, at any time involved in this action, antagonistic to the interests of the corporation."

on the ground that the same is not a finding of fact, but is rather a conclusion of law.

III.

Objection to Proposed Finding No. V.

Plaintiff objects to that portion of this finding (page 4, lines 15-18), viz:

> "That it is not true either as alleged in the complaint, or otherwise, that all or a majority or any of the Board of Directors and officers of Warner Bros. Pictures, Inc. wrongfully participated in the acts and grievances in the complaint complained of,"

on the ground that (1) it is ambiguous; (2) it does not conform to the Court's Opinion (page 54) for the reasons hereinbefore set forth on Page 9, lines 4 to 20. of these objections.

Plaintiff objects to that portion of this finding (page 4, lines 18-21), viz:

> "nor was said Board of Directors dominated or controlled by Harry M. Warner, Jack L. Warner, Albert Warner, Milton Sperling, or any one or more of them."

on the ground that by including the name of Milton Sperling, the same does not conform to the Court's Opinion.

Plaintiff objects to those portions of this finding (page 4, lines 21-30), viz:

> "It is not true that if demand was made upon Warner Bros. Pictures, Inc., that those to whom such application would be made to institute such suit would have permitted the alleged grievances in said complaint complained of, if such existed, to continue or that they, or any of them, would be or were disqualified from

faithfully doing their duty as directors [144] and officers of said corporation because of any matters or facts set forth in said complaint, or otherwise. That no demand was made on the directors of said Warner Bros. Pictures, Inc. to institute this action nor was any demand addressed to the stockholders of said corporation."

on the ground (1) they are ambiguous; (2) they do not conform to the Court's Opinion; (3) if any finding bearing on the content of these proposed portions should be made, it should include a finding on the truth of that portion of plaintiff's claim hereinabove set forth on page 6, lines 15 to 31 of these objections.

Plaintiff objects to that portion of proposed finding No. V (page 4, lines 30-32 and page 5, line 1), viz:

"That the stockholders of said corporation were not at the time of the execution of the contract complained of or at any time or at all under the domination or control of the three brothers Warner,"

on the ground that the same is incomplete and if incorporated into these findings, should be complimented with a finding on that portion of plaintiff stockholder's claim herein contained on page 6, lines 2 to 7, of these objections.

Plaintiff objects to that portion of the proposed findings (page 5, lines 1-4), viz:

"nor was said corporation at any time herein referred to in hands or under control antagon-

istic to the interests of said corporation and its stockholders."

on the ground that the same is not a finding of fact, but is rather a conclusion of law.

Plaintiff objects to those portions of finding No. V (page 5, lines 5-14), viz:

> "That because of the foregoing findings of fact, [145] Warner Bros. Pictures, Inc. should be by the Court realigned as a party plaintiff and that upon such realignment it appears that a plaintiff, Warner Bros. Pictures, Inc., is a citizen of the State of Delaware, and that the defendant, United States Pictures, Inc. is a citizen of the State of Delaware.
>
> That the sole basis of the jurisdiction of this Court is the claim set forth in the complaint of diversity of citizenship and that in view of the realignment of the parties in accordance with these findings, such diversity does not exist."

on the ground that the same are not findings of fact, but are rather conclusions of law.

IV.

Objection to Proposed Finding No. II of the Second Cause of Action.

Plaintiff objects to this proposed finding on the ground that it is not a finding of fact, but is rather a conclusion of law.

V.

Objections to Conclusions of Law as to the Second Cause of Action.

Plaintiff objects to conclusions of law Nos. 2, 3, 4, 5 and 6 on the ground that they do not conform to the Court's Opinion in that the Court, in its Opinion, has concluded to dismiss the second cause of action, not on the ground that it lacks jurisdiction, but on the ground that the same is without equity.

VI.

Objection to the Proposed Judgment.

Plaintiff requests the Court to direct that each side bear its own costs for the reason that it would be consonant with equity so to do under the facts and the uncertainty of the law on the question of this Court's jurisdiction.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY [146]

Affidavit of Service by Mail attached. [147]

[Endorsed]: Filed January 19, 1954.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action came on regularly for trial the 7th day of April, 1953, in the above-entitled Court, Hon. William C. Mathes, District Judge presiding. Plaintiff was represented by Messrs. Moss, Lyon & Dunn and Herman H. Levy,

Esq., defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. were represented by Messrs, Freston & Files, Eugene D. Williams, Esq. and Joseph D. Karp, Esq., and defendants Milton Sperling and United States Pictures, Inc. were represented by Oliver B. Schwab, Esq.

The third cause of action set forth in the complaint was dismissed by the Court without prejudice prior to trial and no findings are herein made with reference thereto.

It appearing to the Court that the issues as to whether this Court has jurisdiction of the subject matter of the action and as to whether the action is barred by the applicable statute of [148] limitations are presented by the pleadings and that said issues should be disposed of in advance of a trial of the other issues in the case, it was ordered that the two issues, (1), as to whether this Court has jurisdiction of the subject matter of the action and (2) as to whether the causes of action are barred by the provisions of the applicable statute of limitations should be tried in advance of the trial of the other issues, and it was ordered that both parties present evidence only as to those two issues.

Thereupon, evidence on behalf of plaintiff and defendants was offered and received, the cause argued and submitted to the Court upon the two above stated issues only. The Court having duly considered the evidence and the law, and being fully advised in the premises, now files the following as its Findings of Fact and Conclusions of Law herein:

Findings of Fact

As to the First Cause of Action, the Court Finds:

I.

That this action was commenced by Edward S. Birn, a citizen of the State of New York, and since the commencement of said action, said Edward S. Birn has died and Charles B. Smith, as special administrator of the estate of Edward S. Birn, deceased, has been substituted in his place as plaintiff. That said Charles B. Smith is a citizen of the State of California.

II.

That defendants Harry M. Warner, Jack L. Warner and Milton Sperling, and each of them, are citizens of the State of California, and that the defendants Warner Bros. Pictures, Inc. and United States Pictures, Inc. are, and each of them is, a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and is a citizen of the State of Delaware; and that as the parties are aligned by the plaintiff, it appears that the plaintiff is a citizen of the State of New York and that the defendants are citizens [149] of the states of California and Delaware, as hereinbefore stated.

III.

That this action was commenced by Edward S. Birn as the owner of four hundred shares of the capital stock of the defendant Warner Bros. Pic-

, during the period of the transactions challenged in the complaint. [Mathes, J.]

tures, Inc., and that he is suing derivatively on behalf of and for the benefit of said defendant Warner Bros. Pictures, Inc., and the stockholders thereof; that by the prayer of the complaint a trust is sought to be impressed on the capital stock and assets of United States Pictures, Inc., in favor of Warner Bros. Pictures, Inc., the agreement between said Warner Bros. Pictures, Inc. and United States Pictures, Inc. referred to in the complaint is sought to be cancelled and terminated and that the defendants Milton Sperling, Harry M. Warner, Jack L. Warner and United States Pictures, Inc. be required to account to Warner Bros. Pictures, Inc., for all losses and damages suffered by it and its subsidiaries and all profits and benefits received by said defendants and that said defendants make restitution accordingly. That the claim set forth in the first cause of action of the complaint, and relief sought, are for and on behalf of the defendant Warner Bros. Pictures, Inc., and that the said Warner Bros. Pictures, Inc. is the real party in interest in said cause of action.

IV.

That the Board of Directors of Warner Bros. Pictures, Inc. is composed of eleven men of whom the defendants Harry M. Warner, Jack L. Warner and their brother Albert Warner, are but three; that the contract in controversy was [Mathes, J.] ^A ~~and all amendments and supplements thereto were and a.e sound busi-~~

~~ness arrangements~~ made and entered into in good faith and without fraud, and said contract ^ was ~~and~~ intended by the directors to be [Mathes, J.] ~~amendments and supplements thereto were~~ of financial [Mathes, J.] ^ benefit to Warner Bros. Pictures, Inc. and its stockholders, and said contract ^ was [Mathes, J.] ~~and said amendments and supplements thereto were~~ considered by said eleven members of the Board of Directors of Warner Bros. Pictures, Inc, to be a sound [150] business arrangement for the best present and future interests of the corporation; that in approving and authorizing the contract ~~and said amendments and supplements thereto,~~ the officers and Board of Directors acted in good faith and exercised their independent business judgment. That at the time of the execution of the contract, Albert Warner, together with the defendants Harry M. Warner and Jack L. Warner, owned ^ less than twenty [Mathes, J.] ~~only about fifteen~~ percent of the outstanding shares of stock of Warner Bros. Pictures, Inc., and that neither the corporation nor the directors or officers were shown to be at that time or at any time under the domination or control of the three brothers Warner above named. That neither the stockholders, its officers or directors were, at any time involved in this action, antagonistic to financial [Mathes, J.] the ^ interests of the corporation.

V.

That it is not true either as alleged in the complaint, or otherwise, that all or a majority or any of the Board of Directors and officers of Warner Bros. Pictures, Inc. wrongfully participated in the acts ~~and grievances~~ in the complaint complained of, nor was said Board of Directors dominated or controlled by Harry M. Warner, Jack L. Warner, Albert Warner, Milton Sperling, or any one or more of them. It is not true that if demand ^ ~~was~~ had been [Mathes, J.] made Warner Bros. Pictures, Inc., that those to whom such application would be made to institute such suit would have ^ ~~permitted the alleged grievances in said complaint complained of, if such existed, to continue or that they, or any of them, would be or were~~ been [Mathes, J.] disqualified from faithfully doing their duty as directors and officers of said corporation because of any matters or facts set forth in said complaint, or otherwise. That no demand was made on the directors of said Warner Bros. Pictures, Inc. to institute this action ^ and such a demand would have been futile; nor was any demand addressed to the stockholders of said corporation. That the stockholders of said corporation were not at the time of the execution of the contract complained of or at any time or at all under the [151] domination or control of the three brothers Warner; nor was said corporation at any time herein

referred to in hands or under control antagonistic financial [Mathes, J.]
to the ^ interests of said corporation and its stockholders.

That because of the foregoing findings of fact, Warner Bros. Pictures, Inc. should be by the Court realigned as a party plaintiff and that upon such realignment it appears that a plaintiff, Warner Bros. Pictures, Inc., is a citizen of the State of Delaware, and that the defendant, United States Pictures, Inc. is a citizen of the State of Delaware.

That the sole basis of the jurisdiction of this Court is the claim set forth in the complaint of diversity of citizenship and that in view of the realignment of the parties in accordance with these findings, such diversity does not exist.

As to the Second Cause of Action, the Court Finds:

I.

Repeats and hereby incorporates all of the preceding findings of fact and applies the same to the second cause of action set forth in the complaint.

II.

That the second cause of action presents a claim for, on behalf of and for the benefit of Warner Bros. Pictures, Inc.; that the plaintiff in the complaint has not included the defendant United States Pictures, Inc. as a defendant in the second cause of action; that complete relief as sought in the second cause of action cannot be accorded between those

now named as parties without the inclusion as a party defendant of United States Pictures, Inc.; the financial interest therein of United States Pictures, Inc. [Mathes, J.] that ^ ~~this Court, as a court of equity, cannot proceed to final decision without United States Pictures, Inc. as a defendant because the interests of~~ and extent [Mathes, J.] ~~such corporation~~ is of such ~~a~~ nature ^ that a final decree cannot be made without affecting that interest or leaving the controversy in such condition that its final determination may be wholly [152] inconsistent with equity and good conscience. That United States Pictures, Inc. is a party so indispensable in this action that a court of equity will not proceed to final judgment without it; and without said corporation as a party defendant, the cause is without equity.

Conclusions of Law

And As Conclusions of Law Based Upon the Foregoing Findings of Fact, This Court Finds and Concludes As Follows:

I.

That the first cause of action sets forth a claim solely for the benefit of Warner Bros. Pictures, Inc., and that said corporation is an indispensable party to said cause of action.

II.

That Warner Bros. Pictures, Inc., its stockhold-

ers, directors and officers are not dominated by the defendants Harry M. Warner, Jack L. Warner and their brother Albert Warner, or any of them, and that said corporation is not and has not been in the hands or under the control of persons antagonistic to the interests of said corporation in said action.

III.

That Warner Bros. Pictures, Inc. should be realigned as a party plaintiff. That upon such realignment, Warner Bros. Pictures, Inc., being a citizen of the State of Delaware, and the defendant United States Pictures, Inc., being a citizen of the State of Delaware, there is no diversity of citizenship and that by reason thereof this Court has no jurisdiction of the subject matter of said action.

As to the Second Cause of Action, the Court Finds and Concludes:

I.

That United States Pictures, Inc. has an interest in the subject matter of the second cause of action of such nature that a [153] final decree cannot be made without either affecting that interest or leaving the controversy in such a condition that final determination may be inconsistent with equity and good conscience and therefore the Court finds that United States Pictures, Inc. is a party so necessary and indispensable that a court of equity will not proceed to determination without it; and that without said corporation as a party, the cause of action is without equity.

II.

That as to the second cause of action, Warner Bros. Pictures, Inc., a citizen of the State of Delaware, should be aligned as a party plaintiff and ~~that~~ United States Pictures, Inc., a citizen of the State of Delaware, ~~should~~ ^ would, if joined [Mathes, J.] be aligned as an indispensable party defendant; and ~~that~~ upon such realignment, there ^ would be [Mathes, J.] ~~is~~ no diversity of citizenship as between the parties plaintiff and defendant.

III.

~~That by reason of the foregoing, this Court is without jurisdiction of the subject matter of said second cause of action.~~

~~IV.~~

As to both causes of action, the Court finds and concludes that upon proper realignment of indispensable [Mathes, J.] the ^ parties, Warner Bros. Pictures, Inc., a Delaware corporation and citizen of the State of Delaware, becomes a party plaintiff, while United States Pictures, Inc., a Delaware corporation and citizen of the State of Delaware, is a party defendant, and that thereby there is no diversity of citizenship as between the parties plaintiff and defendants.

IV.

That there is no claim or showing of Federal jurisdiction of this Court other than the claim of diversity of citizenship and that therefore this Court

the first cause of
is without jurisdiction of the subject matter ^ of ~~this~~
and the second cause of action must be dis-
missed for want of equity [Mathes, J.]
action; ^

V.

the [Mathes, J.]
That ^ ~~this Court is without jurisdiction and that therefore the action should be dismissed, and such~~ judgment of dismissal shall expressly declare that
constitute an [Mathes, J.]
it does not ^ ~~operate as~~ adjudication upon the merits and is without prejudice or res judicata effect.

of dismissal [Mathes, J.]
Let judgment ^ be entered accordingly.

Done in Open Court This 21st Day of January, 1954.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES;
EUGENE D. WILLIAMS and
JOSEPH D. KARP,

/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner. [155]

Affidavit of Service by Mail attached. [156]

[Endorsed]: Lodged December 24, 1953.

[Endorsed]: Filed January 21, 1954.

United States District Court for the Southern District of California, Central Division.

No. 9005-WM Civil

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,
Plaintiff,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC., Defendants.

JUDGMENT OF DISMISSAL

The above-entitled action came on regularly for trial the 7th day of April, 1953, in the above-entitled Court, Hon. William C. Mathes, District Judge presiding. Plaintiff was represented by Messrs. Moss, Lyon & Dunn and Herman H. Levy, Esq., defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. were represented by Messrs. Freston & Files, Eugene D. Williams, Esq. and Joseph D. Karp, Esq., defendants Milton Sperling and United States Pictures, Inc. were represented by Oliver B. Schwab, Esq.

The third cause of action set forth in the complaint was dismissed by the Court without prejudice prior to trial and no findings were made herein with reference thereto.

It appearing to the Court that the issues as to whether this Court has jurisdiction of the subject matter of the action and as to whether the action

is barred by the applicable statute of [157] limitations are presented by the pleadings and that said issues should be disposed of in advance of a trial of the other issues in the case, it was ordered that the two issues, (1) as to whether this Court has jurisdiction of the subject matter of the action and (2) as to whether the causes of action are barred by the provisions of the applicable statute of limitations should be tried in advance of the trial of the other issues, and it was ordered that both parties present evidence only as to those two issues.

Thereupon, evidence on behalf of plaintiff and defendants was offered and received, the cause argued and submitted to the Court upon the two above stated issues only. The Court having duly considered the evidence and the law, and being fully advised in the premises, and having heretofore signed and filed its written Findings of Fact and Conclusions of Law, wherein and whereby judgment was ordered that said action be dismissed;

Now, Therefore, It Is Ordered, Adjudged and Decreed that the above-entitled action be and the

without costs to any party [Mathes, J.]

same hereby is dismissed, ^A ~~and that the defendants do and recover of and from the plaintiff their costs hereby taxed in the sum of $.....~~

constitute [Mathes, J.]

This judgment of dismissal does not ^A ~~operate as~~ an adjulication upon the merits and is without prejudice or res judicata effect.

January 21, 1954.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES;
EUGENE D. WILLIAMS and
JOSEPH D. KARP;
/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner. [158]

Affidavit of Service by Mail attached. [160]

[Endorsed]: Lodged December 24, 1953.
[Endorsed]: Filed January 21, 1954.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR LEAVE TO AMEND COMPLAINT TO CONFORM TO EVIDENCE—MEMORANDUM OF POINTS AND AUTHORITIES

To the Defendants, Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc., and to Their Attorneys, Freston & Files and Eugene D. Williams; to the Defendants, Milton Sperling and United States Pictures, Inc., and to Their Attorney, Oliver B. Schwab:

You and Each of You Will Please Take Notice that on Monday, February 15, 1954, at 10:00 a.m. of said day or as soon thereafter as counsel can be heard at the courtroom of the Honorable William Mathes located in the Federal Courthouse, Los Angeles, California, plaintiff Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, deceased, will move the court for leave to file an amended and supplemental complaint in the

above entitled action, to conform to the evidence at the [161] trial thereof as set forth in the proposed Amended and Supplemental Complaint, a copy of which is attached hereto and made a part hereof.

Said motion will be made upon the grounds that an amended and supplemental complaint is necessary to conform the pleadings to the evidence adduced at the trial of the action of the issues of jurisdiction and the Statute of Limitations.

Said motion will be based upon this notice, memorandum of points and authorities, the proposed amended and supplemental complaint, a copy of which is served herewith, and the pleadings, records, files and minutes of the court in the within action.

Dated: February 5, 1954.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.

Memorandum of Points and Authorities.

I.

Amendments of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time and such motion may be made after judgment.

Rule 15 (a) Federal Rules of Civil Procedure.

Simms vs. Andrews, 118 F.2d 803.

Sears Roebuck & Co. vs. Marhenke, 121 F.2d 598.

II.

The court may permit a party to serve a supplemental pleading setting forth transactions or occurrences or events which have happened since the date of the pleading sought to be supplemented.

Rule 15 (d) Federal Rules of Civil Procedure.

III.

Leave to amend pleadings should be freely and liberally granted.

Rule 15 (a) Federal Rules of Civil Procedure.
Snyder vs. Dravo Corp., 6 F. R. D. 546.

Respectfully submitted,

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff. [163]

Affidavit of Service by Mail attached. [164]

[Endorsed]: Filed February 5, 1954.

[Title of District Court and Cause.]

AMENDED AND SUPPLEMENTAL COMPLAINT (AFTER TRIAL TO CONFORM TO PROOF) AND FOR ACCOUNTING AND DAMAGES

Plaintiff Edward S. Birn having sued herein derivatively on behalf and for the benefit of defend-

ant Warner Bros. Pictures, Inc., and the stockholders thereof; and upon his death the Special Administrator of his estate in California having, by order of this court, been duly substituted as party plaintiff; and plaintiff having first obtained leave of the court so to do, now files this amended and supplemental complaint after trial to conform to proof, as follows: (All of the allegations below being upon information and belief except allegations "1" to "4", inclusive, and allegation "24", which are alleged as of plaintiff's knowledge.

For a First Cause of Action Against All Defendants.

1. Jurisdiction herein is founded on diversity of citizenship and amount. This action is not a collusive one to confer on [165] this court jurisdiction of an action over which it would not otherwise have jurisdiction.

2. The matter in controversy exceeds, exclusive of interest and costs, the sum of $3,000.

3. Plaintiff's decedent was a citizen of the State of New York, and the estate of said decedent is in the course of probate in said state.

4. Plaintiff's decedent was the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc. throughout the time that the transactions herein complained of occurred. He has owned said stock since August 21, 1944.

5. Defendants Warner Bros. Pictures, Inc., (hereinafter referred to as Warner Bros.) and United States Pictures, Inc., (hereinafter referred

to as United) are corporations incorporated under the laws of the State of Delaware, engaged in the motion picture business and said corporations do business and maintain offices in the County of Los Angeles and State of California.

6. The defendants Milton Sperling, Harry M. Warner and Jack L. Warner are citizens of the State of California.

7. During the time that the transactions hereinbelow complained of occurred, the defendants, Harry M. Warner and Jack L. Warner, were officers of Warner Bros. Harry M. Warner was President, and Jack L. Warner a Vice-president.

8. The following persons were directors of Warner Bros. during the periods stated after their respective names

Harry M. Warner, 1923 to date; Jack L. Warner, 1923 to date; Albert Warner, 1923 to date; Wadill Catchings, 1925 to date; Morris Wolf, 1926 to date; Stanleigh P. Friedman, 1931 to date; Charles S. Guggenheimer, 1932 to date; [166] Samuel Carlisle, 1934 to date; Robert W. Perkins, 1936 to date; Samuel Schneider, 1944 to date; Joseph Bernhard, 1936 to September 10, 1945; John E. Bierwirth, November, 1945 to date.

9. Harry M. Warner, Jack L. Warner and Albert Warner are brothers and Milton Sperling was at all times herein mentioned and is the son-in-law of Harry M. Warner.

10. At all times herein mentioned, Warner Bros. was a publicly owned corporation. Harry M. Warner and Jack L. Warner, together with their

brother Albert Warner owned a large block of its outstanding stock, to-wit: approximately 16%, and did actively direct its supervision, policies, actions and business, including the acts hereinafter alleged in this complaint. The public, namely, some 30,000 shareholders located in the various states of the United States, and in countries all over the world, owned the remainder of the company's stock.

11. Since 1945, Warner Bros. has participated with United in a series of nine transactions which involved the investment by Warner Bros. of millions of dollars in ventures in motion picture production-distribution, the sharing of profits in said ventures, accounting to each other for losses and the payment of large sums of money to said Sperling and Bernhard, under a contract and a series of five successive amendments thereto.

12. The contract is dated September 28, 1945. It was approved by the Warner Board of Directors on said day. Plaintiff claims and alleges that Harry Warner, as President of Warner Bros., participated in negotiations which preceded the drawing and approval thereof. It is hereinafter referred to as the "basic contract".

13. The first three amendments to the basic contract were entered into prior to the commencement of this suit, to-wit: [167] Amendment dated November 2, 1945; amendment dated May 20, 1946, and amendment dated December 6, 1947. The first two of said amendments were approved by the Warner Board of Directors. The third amendment was neither submitted to nor approved by the War-

ner Board before the suit was commenced. The fourth and fifth amendments to the basic contract were entered into during the pendency of the suit. They are dated July 21, 1950, and August 12, 1952, and were approved by the Warner Board of Directors. Plaintiff claims and alleges that Harry Warner, as President of Warner Bros. participated in the negotiation of all said amendments; and when the third, fourth and fifth amendments were executed, Harry Warner and his daughter Betty Sperling had a financial interest in United.

14. Plaintiff attaches photostat copies of the basic contract and all said amendments, refers to them and makes them a part of this amended and supplemental complaint as though fully set forth at length.

15. On or about August 6, 1945, United was caused to be organized for the purpose of engaging with Warner Bros. in said ventures. United's capital stock was issued to Sperling and to said Bernhard, who was then a Warner director, and a resident of the State of New York, and who subsequently resigned from the Warner Board and severed his connection with Warner Bros., to-wit: his employment contract with Warner Bros. was terminated and in connection with such termination, Warner Bros. awarded him $78,000 "severance pay"; although his employment contract contained no provision entitling Bernhard to severance pay. Since September 1946, Sperling has been United's only stockholder, with the exception of 62 shares which, prior to the commencement of this

action, he assigned to Title Insurance and Trust Company of Los Angeles, California, a California corporation, to be held in trust for the benefit of his minor children, who are Harry Warner's grandchildren. [168]

16. Plaintiff claims and alleges that United was organized as aforesaid in order that through it, Sperling might utilize Warner Bros. funds, its facilities, assets and business opportunities in a manner unfair to Warner, unwarrantedly favorable to United and Sperling; and, to further and enrich Sperling's private interests at Warner Bros. expense.

Plaintiff claims and alleges that the basic contract and said amendments are unfair to Warner Bros. and unwarrantedly favorable to United and Sperling. That all said agreements have been performed in a manner unwarrantedly favorable to United and Sperling and unfair to Warner Bros. and that the aforementioned $78,000 award to Bernhard was unlawful.

17. Plaintiff claims and alleges that at the time of the making of the basic contract, it was intended by defendants that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of said six motion pictures by means of the borrowing privileges set forth in Paragraph 31 of the basic contract.

18. That in furtherance of the intention as set forth in the preceding paragraph, and pursuant to the provisions of Paragraph 31 of the basic con-

tract, the defendants caused an agreement to be entered into between Warner Bros. and United and The New York Trust Company (the latter being a New York banking corporation), which provides for the loan by The New York Trust Company to United of the latter's share of the cost of production of pictures, and under said agreement, United pledged and caused to be pledged to said bank, three pictures and the net income therefrom, as security for the repayment of loans to United on said pictures;

19. Plaintiff claims and alleges that said loan agreement was effectuated through the use of the valuable credit and banking facilities and connections of Warner Bros. in that said [169] John E. Bierwirth was the President of The New York Trust Company and his influence was used by Warner Bros. and Joseph Bernhard to effect said loan agreement, and further, in that Warner Bros. was and is a valued customer of The New York Trust Company and its patronage was favorably sought for various reasons including the fact that Warner Bros. was then indebted to a syndicate of banks, including The New York Trust Company, to the extent of several million dollars.

20. That in pursuance of all the agreements hereinbefore referred to, and during the period commencing in or about January, 1946, to approximately September, 1947, United has borrowed large sums from The New York Trust Company and the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being

used by United, and the said agreements have been in part performed and motion pictures were and are being produced and distributed under said agreements and said agreements remain in part unperformed.

21. That in connection with the performances of said agreements, United has not advanced any of its private funds or capital and has contributed to the costs of production of three of said pictures solely out of loans from The New York Trust Company, and that all other capital required for the production of said three pictures and six additional pictures has been contributed by Warner Bros.

22. Plaintiff claims and alleges that defendants have designed and contrived to cause said agreements to be performed in a manner unfair to Warner Bros. and to benefit and to further the interests of United and Sperling at the expense of and detriment to Warner Bros. That said agreements have not been made, performed and administered as "arms length" transactions between Warner Bros. and United.

23. That in or about or prior to the summer of 1945, the [170] individual defendants did illegally, wrongfully and in bad faith, conspire and act together and did conspire and still continue to conspire to waste, mismanage, divert and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling and United at the expense of Warner Bros. and regardless of

the consequences to Warner Bros., and each of the different things and acts done and being done by said individual defendants, and by the corporate defendants through their directors and officers, as herein alleged, were, among others, and continue to be, all steps in said conspiracy and were and are being committed pursuant thereto, and in furtherance of said objects. That in performing such acts and doing such things, defendants acted and continue to act unfairly to Warner Bros, and for the benefit of and advantage to United and Sperling; and the defendants Harry Warner and Jack Warner were and continue to be unfair and disloyal to their trust as directors and executive officers of Warner Bros.

Plaintiff claims and alleges that defendants Harry and Jack Warner, together with their brother Albert Warner, did actually select, dominate and control the other directors and officers of Warner Bros.

24. That plaintiff's decedent did not discover the facts herein set forth until October of 1948, and plaintiff's decedent had no notice or information of circumstances which would put him on inquiry regarding such facts until October of 1948.

25. That by reason of the premises, Warner Bros. has suffered and still suffers improper and illegal waste, mismanagement, misappropriation and diversion of its valuable assets, credits, facilities and business opportunities all to its loss and to the improper and personal profit and benefit of United and Sperling, in that:

(a) Warner Bros. has been and is being subpected to [171] undertaking unfair, extraordinary and unwarranted risks of capital and other loss and injury in said ventures;

(b) Warner Bros. vast organization, its capital, its picture making facilities, described in the basic agreement, have been and are being made available to and utilized by, United, and through it, Sperling, without adequate, reasonable, legal considerations, return or payment to Warner Bros.; and under terms and conditions which fail to adequately safeguard Warner Bros. against advantage being unduly and improperly taken of Warner Bros. by United and Sperling, in the course of their participation in these ventures;

(c) The distribution fees and percentages of profits provided to be paid to Warner Bros. are unreasonably low and unfair to Warner Bros.;

(d) The last three amendments to the basic contract were calculated to and did compound and increase the unfairness to Warner Bros. of the terms of the basic contract and did, at Warner Bros. risk and expense, provide additional unfair advantage to United and corresponding disadvantage to Warner Bros.; and, said amendments were calculated to and did postpone and they continue to postpone unreasonably and indefinitely United's obligation to pay Warner Bros. approximately $850,000, namely, the loss suffered by Warner Bros. in the third of such ventures;

(e) The subordination and use of the capital assets and facilities of Warner Bros. in favor of,

and as collateral security for, the aforesaid loans to [172] United, constitutes an improper or illegal use of property of Warner Bros. for which the latter receives in return no legal, adequate or fair consideration;

(f) The subordination and use of the capital, assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constituted a breach of the existing written agreement between Warner Bros. and a syndicate of banks under which Warner Bros. is the recipient of large business loans totalling several millions of dollars, and the said last named written agreement with said banks prohibits such use of the capital and assets of Warner Bros., and thereby Warner Bros. has been endangering said loans and injuring its credits.

(g) In the performance of the basic contract and the amendments, United received unfair and unwarranted advantages at Warner Bros. expense; and United was furthermore permitted to and it did violate the terms of the said agreements and thereby gained unfair and unwarranted advantage, at Warner Bros. expense and to its detriment.

26. That by reason of the premises, the defendant United and its assets, and the profits and benefits derived by it from Warner Bros. under the above mentioned agreements, are substantially based upon, result from, and stand in the place of, the assets and business opportunities wrongfully diverted from Warner Bros. to United, and hence the [illegible] of United and all of its said assets

belong in equity and good conscience to Warner Bros.

27. Demand upon the directors of Warner Bros. to institute this action would have been futile and plaintiff had made no such [173] demand because all or a majority of the present Board of Directors and officers of said corporation wrongfully participated in the acts and grievances herein complained of and said Board of Directors is controlled by the active wrongdoers herein, and since those to whom application would have to be made to institute this suit are the same persons who wrongfully caused or permitted the grievances herein complained of, such persons would refuse to bring suit against themselves and in fact would be disqualified from faithfully doing so.

28. Plaintiff's decedent has made no demand upon the stockholders of Warner Bros. because under the laws of Delaware the management of Warner Bros. is directed by its Board of Directors and the stockholders cannot bring suit for Warner Bros., nor require the Board of Directors to bring such suit; and further because the defendants Jack L. Warner and Harry M. Warner and their brother Albert Warner hold upwards of sixteen per cent (16%) of the total issued stock of Warner Bros. and the balance of such stock is held by upwards of 30,000 stockholders widely scattered over the United States and foreign countries all over the world making it virtually impossible and impractical to obtain concerted action by the stockholders

and would entail a prohibitive cost and expense to the plaintiff.

29. Plaintiff has no adequate remedy at law and he and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted.

For a Second Cause of Action Against All Defendants Except United and Sperling:

30. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "29" (except "23"), inclusive, with the same force and effect as though herein alleged.

31. That by reason of the acts committed by these defendants as herein alleged, the defendants Harry and Jack Warner, [174] while acting in their fiduciary capacities and while charged with their fiduciary duties as directors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, nonfeasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

Wherefore, plaintiff demands judgment as follows:

(1) That the defendants account to Warner Bros. for all losses and damages suffered by it and for all profits and benefits received by said defendants, and that defendants make restitution accordingly.

(2) That a trust be impressed upon the capital

stock and assets of United in favor of Warner Bros.

(3) That the agreement between Warner Bros. and United to the extent that the same is unexecuted and to the extent that it is practicable to do so, should be cancelled and terminated.

(4) That defendents Harry M. Warner and Jack L. Warner make whole Warner Bros. Pictures, Inc. for all damages that it has suffered because of such defendants' successive breaches of their fiduciary duty to Warner Bros. Pictures, Inc., or arising out of the same, and because of their illegal and wrongful acts herein alleged.

(5) That plaintiff be allowed the costs, disbursements and expenses of this action, including reasonable counsel and accountants fees.

(6) That such other and further relief be granted as shall be equitable in the premises.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By. HERMAN H. LEVY,
Attorneys for Plaintiff. [175]

Duly Verified. [176]

Affidavit of Service by Mail attached. [182]

[Endorsed]: Lodged February 5, 1954.

[Title of District Court and Cause.]

ORDER DENYING MOTION FOR LEAVE TO AMEND

The motion of plaintiff for an order granting him leave to file an amended and supplemental complaint came on regularly to be heard the 15th day of February, 1954, before Hon. William C. Mathes, District Judge, and was duly made, presented and argued.

Upon due consideration thereof, it is now ordered that said motion be and the same hereby is denied.

Done in Open Court February 15, 1954.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES and
EUGENE D. WILLIAMS,

/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner. [183]

Approved As to Form:

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.

OLIVER B. SCHWAB, ESQ.,

/s/ By OLIVER B. SCHWAB,
Attorney for Defendants Sperling and United States Pictures, Inc. [184]

[Endorsed]: Filed March 31, 1954.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that plaintiff Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, Deceased, hereby appeals to the Court of Appeals for the Ninth Circuit from the Judgment of Dismissal entered January 21, 1954.

Dated: February 16, 1954.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By GEORGE C. LYON,
Attorneys for Plaintiff. [185]

Affidavit of Service by Mail attached. [186]

[Endorsed]: Filed February 17, 1954.

[Title of District Court and Cause.]

STIPULATION

The plaintiff having moved this Court for an order granting him leave to file an amended and supplemental complaint to conform to the proof, to which were to be attached the following contracts between the corporate defendants to wit: Contract dated September 28, 1945; Amendment dated November 2, 1945; Amendment dated May 20, 1946; Amendment dated December 6, 1947; Amendment dated July 21, 1950; and Amendment dated August 12, 1953, and

The Motion having duly come on to be heard in

open Court on the 15th day of February, 1954, before the Honorable William C. Mathes, District Judge, and

The Court having heard argument thereon by the undersigned, in the course of which the undersigned attorneys for the defendant agreed to enter into the following stipulation, [192]

It Is Stipulated As Follows:

The undersigned attorneys for the defendants agree (1) that each and all of plaintiff's claims which are set forth in the said proposed amended and supplemental complaint have been duly brought to the notice and attention of this court during and prior to the trial heretofore had herein; (2) in the event of an appeal from the judgment heretofore entered on January 21, 1954, the undersigned attorneys for plaintiffs will not urge, in the Appellate Courts, that the subject matter which is contained in said proposed amended and supplemental complaint, or any part thereof, is being raised by plaintiff for the first time on appeal.

Dated: February 15, 1954.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorney for plaintiff.
FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for defendants, Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc.

/s/ OLIVER B. SCHWAB,
Attorney for Defendants Milton Sperling and United States Pictures, Inc. [193]

[Endorsed]: Filed March 31, 1954.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 196, inclusive, contain the original Complaint; Answer of Defendants Sperling et al; Answer of Defendants Harry M. Warner et al; Stipulation of Facts; Motion for Leave to File Amended and Supplemental Complaint; Objections to Motion for Leave to File Amended and Supplemental Complaint; Order Denying Motion for Leave to File Amended and Supplemental Complaint; Stipulation Concerning Other Stockholders' Cases; Memorandum of Decision; Objections to Findings of Fact and Conclusions of Law; Findings of Fact and Conclusions of Law; Judgment of Dismissal; Motion for Leave to Amend Complaint to Conform to Evidence, etc.; Proposed Amended and Supplemental Complaint to Conform to Proof, etc.; Order Denying Motion for Leave to Amend; Notice of Appeal; Stipulation and Order Extending Time to Docket Appeal; Designation of Record on Appeal; Stipulation; Stipula-

tion re Designation of Record and a full, true and correct copy of Minutes of the Court for April 12, 1954, which, together with the original exhibits and copy of reporter's transcript of proceedings on trial, transmitted herewith, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing and certifying the foregoing record amount to $2.00 which sum has been paid to me by appellant.

Witness my hand and the seal of said District Court this 27th day of April, A.D. 1954.

[Seal] EDMUND L. SMITH,
Clerk
/s/ By THEODORE HOCKE,
Chief Deputy.

In the United States District Court, Southern District of California, Central Division

No. 9005-WM-Civil

Edward S. Birn, Plaintiff, vs. Milton Sperling, Harry M. Warner, Jack, L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Defendants. (now entitled): Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, Deceased, Plaintiff, vs. Milton Sperling, et al., Defendants.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Los Angeles, Calif., Tuesday, April 7, 1953

Honorable William C. Mathes, Judge Presiding.

Appearances: For the Plaintiff: Messrs. Moss, Lyon & Dunn and Herman H. Levy, Esq. For the Defendants Warner: Messrs. Freston & Files, Eugene D. Williams, Esq., and J. D. Karp, Esq. For the Defendants Milton Sperling and United States Pictures, Inc.: Oliver B. Schwab, Esq. [1*]

Mr. Williams: If your Honor please, before we do start, may I have the privilege of asking to have associated as counsel for the Warner defendants Mr. Joseph D. Karp, of New York City. Mr. Karp is admitted to practice in all of the courts of the State of New York and in the United States [3]

* Page numbers appearing at top of page of original Reporter's Transcript of Record.

District Courts for the Southern and Eastern Districts of New York, and also in the Court of Appeals for the Second Circuit.

The Court: You move his admission?

Mr. Williams: I move his admission for this case. I, of course, vouch for his integrity and ability.

The Court: The motion will be granted. [4]

* * * * *

Mr. Levy: I proceed now, sir, to reading a list of interrogatories which is marked Exhibit 105, the answers to which are contained in Exhibit 105-A for identification. Both exhibits are now in for identification only.

"To the defendant United States Pictures, Inc.:

"Pursuant to the order of court dated April 11, 1949, authorizing plaintiff to serve and file additional interrogatories, please furnish, under oath, written answers to the following interrogatories:

* * * * * [271]

The Court: These are matters that deal with accounting?

Mr. Williams: Yes, your Honor. [272]

* * * * *

The Court: Do you have to read it into the record at this juncture? If you wish it in the record at this point, wouldn't it be just as well to have the reporters copy them into the record, or is it something that you wish me to hear at this point? [273]

Mr. Levy: No, I do not think that a reading of it will have any greater effect on your Honor at this point, would give your Honor a greater understanding of the relevancy and the meaning of these

figures if read rather than heard. But in view of the fact that my brother Williams objects to the introduction of the physical document itself, I must read the figures into the record so that the record will contain the answer to the interrogatory.

The Court: Do you wish the document in the record at this point because of the orderly presentation of the evidence? As far as I am concerned, it would not help me to have you read these figures to me.

Mr. Levy: I agree, your Honor.

The Court: It may be helpful, and it has been up to this point, to have you present the matter in a certain chronological fashion. Otherwise I would urge you to offer it all into evidence and permit me to read it, instead of going through this much slower process of listening to it.

Mr. Levy: Yes, your Honor.

The Court: We are coming, gentlemen, I think, to the point where it will be desirable to revert to my former practice, and that is to receive all these matters into evidence, and of course the record on appeal may be limited to avoid duplications and unnecessary matters. [274]

* * * * *

The Court: Here is the way I view it, gentlemen: This is the plaintiff's case. On the plaintiff's case he may, within the limitations of the rules, make his record as he thinks best. The same with the defendants when the time comes to introduce the defendants' evidence.

I will reverse my rulings as to Exhibits 103,

103-A, 104, 104-A, and 104-B and receive those documents into evidence. [275]

* * * * *

(The documents previously marked Plaintiff's Exhibits 103, 103-A, 104, 104-A and 104-B, were received in evidence.) [276]

* * * * *

(The documents previously marked Plaintiff's Exhibits 105 and 105-A were received in evidence.) [279]

* * * * *

The Court: You may proceed in the case on trial.

Mr. Levy: Referring, if the court please, to Exhibits 105 and 105-A from which I read just before the adjournment, I shall read, with the court's permission, only two or three of the interrogatories contained in that exhibit which set forth a fact or facts without long lists of figures, and rely upon the factual content of these exhibits, rely for the actual content of these exhibits on the physical documents themselves, which I shall offer into evidence.

The Court: I suggest you first offer into evidence the documents themselves.

Mr. Levy: Yes, your Honor.

Mr. Williams: I understand they have already been received.

* * * * *

Mr. Levy: This Exhibit 105, incidentally, is dated April ..., as I have it here, 1949. But, as I have read before, it was served pursuant to an order of this court [280] dated April 11th and the an-

swers to the interrogatories are dated May 18, 1949 and verified by J. C. Yoss, Treasurer, United States Pictures. [281]

* * * * *

Mr. Levy: Next are 106 and 106-A.

Exhibit 106, may it please the court, is a list of interrogatories addressed to the defendant United States Pictures, pursuant to an order of this court dated February 27, 1950. It is dated—and I refer now to Exhibit 106—March 24, 1950.

The answers thereto are contained in Exhibit 106-A. That exhibit contains a notation, namely, "Submitted March 25, 1950."

* * * * *

The Court: Do you offer them in evidence? [286]

Mr. Levy: I do offer them in evidence at this time.

Mr. Williams: May the record show that the date of the verification of Exhibit 106 is July 20, 1950?

The Court: Exhibits 106 and 106-A for identification are received in evidence.

(Plaintiff's Exhibits 106 and 106-A for identification were thereupon received in evidence.)

* * * * * [287]

I proceed now, your Honor, to Exhibit 107, marked for identification up to the present time. That exhibit contains both the interrogatories and the answers thereto. I now offer Exhibit 107 for identification into evidence.

The Court: Is there objection? [299]

* * * * *

(The document heretofore marked Plaintiff's Exhibit 107, was received in evidence.) [300]

* * * * *

Attached to this exhibit are schedules, if the court please, commencing with Schedule A, the pages of which are unnumbered, however, and proceeding down to and including Schedule H which, incidentally, is the August 12, 1952 amendment, namely, the latest amendment to the master contract.

That, if the court pleases, is the substance of the Exhibit No. 107 in evidence.

The Court: I take it the schedules attached to Exhibit 107 are understood by the parties to be in evidence.

Mr. Williams: Yes, your Honor. [423]

The Court: As part of the exhibit.

Mr. Levy: Yes, your Honor.

The Court: And that they should be given various identifying letters. Schedules A to H, inclusive, shall have in this record here the same identifying letter under the Exhibit 107 as those exhibits are given in Exhibit 107 itself. In other words, Schedule A will be in this record Exhibit 107, Schedule A of Exhibit 107.

Mr. Levy: Yes, your Honor, and so referred to throughout the trial as Schedule A of Exhibit 107 in evidence?

The Court: Yes, for the purposes of identifying in this record here as distinguished from the identification in the exhibit itself.

Mr. Levy: Yes, your Honor.

(The schedules were marked Schedules A to H, inclusive, to Exhibit 107 in evidence.)

Mr. Levy: I proceed to the reading of Exhibit 108—I withdraw that. May I at this time offer Exhibits 108 and 108-A into evidence. [424]

* * * * *

The Court: In the case on trial you may proceed. Have Exhibits 108 and 108-A been offered?

Mr. Levy: My recollection is that they have, your Honor.

* * * * *

(The documents were thereupon marked Plaintiff's Exhibits 108 and 108-A and received in evidence.)

Gentlemen, if there is no objection, when ever an order is made receiving in evidence any deposition, interrogatories or answers thereto, requests for admissions or answers or responses thereto, or any other exhibit to which there is attached one or more charts, schedules or other writings or exhibits, all such attachments shall be deemed likewise received in evidence, and shall be identified in the records of this trial as a subdivision of the exhibit of which a part, and shall be sub-numbered or sub-lettered as the case may be, or otherwise given the same identification as in the exhibit of which a part.

Is that agreeable?

Mr. Levy: It is agreeable.

The Court: So ordered. You may proceed, Mr. Levy. [426]

* * * * *

The Court: Were the requests for admissions directed to all?

Mr. Levy: Yes, sir, your Honor, to Harry M. Warner, Jack L. Warner, and Warner Bros. Pictures, Inc.

The Court: Is it stipulated that the admissions are the admissions of all the defendants to whom the requests were directed?

Mr. Williams: Yes, if your Honor please. [427]

* * * * *

"Request No. 4. That at all times mentioned in Plaintiff's complaint, Defendants Harry M. Warner and Jack L. Warner together with their brother Albert Warner did actively direct the supervision, policies, actions and business of Warner Bros. Pictures, Inc."

The answer thereto is: "Yes."

"Request No. 5. That at all times mentioned in Plaintiff's complaint, the defendants Harry M. Warner and Jack L. Warner together with their brother Albert Warner exercised the selection of directors and officers of Warner Bros. Pictures, Inc."

The answer is: "No." [430]

* * * * *

Request No. 8:

"That there are no other independent producers contracts entered into by Warner Bros. Pictures, Inc. with the same terms and conditions as the contract with United States Pictures, Inc."

The answer is: "Yes."

Request No. 9:

"That at the time of the making of the agreement of September 28, 1945, between Warner Bros. and United States Pictures, Inc., it was intended by the parties thereto that United was not to advance any of its private funds or capital in the performance of said agreement, but was to meet its share of the cost of production of the motion pictures to be produced thereunder by means of the borrowing privileges set forth in said agreement."

The answer thereto is: "No." [432]

Request No. 10:

"That the loan agreement dated October 31, 1945, between The New York Trust Company, United States Pictures, Inc., and Warner Bros. Pictures, Inc. was effectuated through the credit and banking facilities and connections of Warner Bros."

The answer thereto is: "No."

Request No. 11:

"That pursuant to the agreements between United and Warner Bros., and The New York Trust Company and United and Warner Bros., and during the period commencing in or about November, 1945, to date, the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being used by United."

The answer thereto is:

"No; except as the funds, credits, and facilities of Warner Bros. are provided by the contract of November, 1945, between United States and Warner's, to be so used, and except as provided by all amendments and supplements to said contract."

Request No. 12——

Mr. Williams: Incidentally, before we leave that, we were actually referring to the contract of September 28, 1945. [433] Don't you think it would be better if we agreed to stipulate that instead of "November, 1945," it should be "September 28, 1945," in that answer?

Mr. Levy: Your statement to the effect that that is what you intended is perfectly satisfactory to me, and I will so stipulate, your Honor.

The word "November" may be by Mr. Williams changed in the original, and in its place there may be substituted the words "September 28, 1945."

Request No. 12:

"That during the period January 1, 1945, to November 23, 1950, Warner Bros. has not asked for, nor has there been given, the written consent of the holders of 75 per cent in amount of the outstanding notes referred to in paragraph 10 of the Stipulation of Facts on file in the within action permitting any lien or incumbrances to exist on any of the following assets of Warner Bros. or its subsidiaries:

"(a) Motion pictures, photoplays produced in the United States or Canada.

"(b) Accounts or notes receivable or moneys due or to become due under contracts."

The answer thereto is: "Yes." * * * * * [434]

I proceed now, if the court please, to Exhibit 109 in evidence, and I at this time offer Exhibit 109 and 109-A in evidence.

The Court: They may be received in evidence.

(Plaintiff's Exhibits 109 and 109-A for identification were thereupon received into evidence.)

Mr. Levy: 109 contains a series of requests for admissions addressed to the defendants Milton Sperling and United States Pictures, as follows:

Before I read them, may I state that Exhibit 109, namely, the requests, is dated July 20, 1951, and the answers thereto that are contained in Exhibit 109-A are dated August 2, 1951, and were verified on the same day, namely, August 2, 1951?

* * * * * [435]

Request No. 2:

"That at the time of making the agreement dated September 28, 1945, between Warner Bros. Pictures, Inc. and United States Pictures, Inc. it was intended by the parties thereto that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of the motion pictures to be produced thereunder by means of the borrowing privileges set forth in said agreement."

The answer is: "This is denied."

Request No. 3:

"That pursuant to said agreement dated September 28, 1945, and during the period commencing in or about November, 1945, to date the funds, credits, facilities, assets, and business opportunities of Warner Bros. were and still are being used by United States Pictures, Inc."

The answer is as follows:

"Pursuant to the agreement dated September 28, 1945, as amended and supplemented, U. S. Pictures has received advances from Warner Bros. toward the cost of production of its pictures, in accordance with [436] provisions of said agreement as amended and supplemented, and has to that extent used Warner Bros. funds and credits. Also, pursuant to said agreement dated September 28, 1945, as amended and supplemented, United States Pictures has utilized the studio and facilities of Warner Bros, in the making of its pictures and to that extent has used the facilities and assets of Warner Bros. Except so as admitted, No. 3 is denied." [437]

* * * * *

Request No. 6:

"That the contract dated September 28, 1945, between Warner Bros. and United States Pictures, Inc. was negotiated by defendant Milton Sperling and defendant Harry M. Warner."

The answer is as follows:

"Milton Sperling and Harry M. Warner each participated to some extent in the negotiations for the contract dated September 28, 1945, but other persons had an important part in the negotiations."

* * * * *

I proceed now, if the court please, to a reading [439] of Exhibit 110, and before doing so I offer it in evidence.

The Court: Received in evidence.

(Plaintiff's Exhibit No. 110 for identification was thereupon received in evidence.) [440]

* * * * *

Mr. Levy: Very well. These are requests directed to defendants Harry M. Warner and Jack L. Warner, and each of them, and the answers, as I believe I indicated a moment ago, sir, are contained in the same exhibit, the answer following the request in each case.

"Request No. 1. Warner's business is producing motion pictures.

A. True in part; but in addition to producing motion pictures, Warner through its subsidiaries is [441] also engaged in the business of distributing motion pictures and, until March 2, 1953 was in the business of exhibiting motion pictures in hundreds of motion picture theatres operated by its subsidiaries. Warner derives no profit as such from its production of motion pictures; its profits are derived and were derived from exhibition and distribution of motion pictures. For example, in the fiscal year 1944-1945, Warner's net profit from distribution was about $4,590,000, and from exhibition about $5,310,000; in the fiscal year 1947-1948 distribution resulted in a net loss of about $246,000, while exhibition resulted in a profit of about $12,000."

Mr. Williams: "$12,000,000."

Mr. Levy: "$12,000,000."

"Request No. 2. A series of buildings and other structures located in Burbank acquired and maintained at considerable cost, house Warner's many and varied picture making facilities.

A. True.

Request No. 3: A number of departments, headed

by executives employ the varied skills of men and women trained in the arts and many sciences; business administrators, accountants, lawyers; and the labor, [442] skilled and unskilled of a large personnel.

A. True.

Request No. 4: The total cost of Warner's production program for the fiscal year 1944 to 1945 as reported by Price, Waterhouse & Co. was approximately $31,000,000."

Mr. Williams: "$31,300,000."

Mr. Levy: "$31,300,000." Thank you.

The answer: "True; said costs being about $22,000,000 direct and about $9,300,000 overhead.

Request No. 5: Warner's product, namely prints of pictures put up in cans, is supplied to motion picture exhibitors throughout the world on a rental basis.

A. True in part; and to this extent, namely, that Warner produced positive prints of motion pictures which are supplied through motion picture exchanges in the United States and foreign countries to motion picture exhibitors on either a percentage or a flat rate license basis, and to theatres operated by Warner and its wholly owned subsidiaries.

Request No. 6. A subsidiary company and affiliated companies handle the distribution and exploitation of Warner's pictures, the booking and contracting for the rentals, the publicizing, [443] advertising, the delivery of the product to exhibitors and the collection of the income therefrom.

A. True in part; but it should be added that there are several subsidiary companies and that in addition to those referred to in the request for admissions, there are theatre companies owned and operated by Warner. [444]

* * * * *

Request No. 9. Warner's system of bookkeeping is so designed as to enable Warner to determine, among other things, the total production cost to Warner of each picture produced.

A. True.

Request No. 10. The said system separates 'production costs' into two categories; 'direct' costs and 'overhead' costs.

A. True.

Request No. 11. During the fiscal year, 1944-1945, as reported by Price, Waterhouse & Co. some $9,300,000.00 or approximately 42%, constituted Warner's 'overhead'.

A. True.

Request No. 12. Warner's stock is publicly owned [445] and is listed on the New York Stock Exchange.

A. True.

Request No. 13. In 1945 Harry Warner was and still is Warner's president and chief executive.

A. True.

Request No. 14. In 1945 Jack Warner was and still is a Warner vice-president and an executive in charge of production.

A. True.

Request No. 15. The defendants Harry and Jack

Warner reside in California and look after matters requiring company attention on the West Coast and Albert Warner who resides in New York attends to matters in the East.

A. True in part; but it is also true that Harry Warner frequently, and Jack Warner occasionally, attends to matters requiring the company's attention in the East. [446]

* * * * *

Request No. 19. Between them, the three brothers own approximately 15% of Warner's outstanding stock.

A. True as of the year 1945; but from time to time the holdings of the three brothers vary in amount and in percentage of the outstanding stock.

Request No. 20. The rest of the said stock is distributed among approximately 30,000 shareholders located in various parts of the world. [447]

A. True.

Request No. 21. In the year 1945, the Warner Board of Directors was composed of eleven men.

A. True.

Request No. 22. Four of the said directors were lawyers, who, or the law firms in which they are partners, received substantial annual or other compensation from Warner.

A. True.

Request No. 23. Three of said directors were employees whom Warner paid substantial annual salaries.

A. True in part; until September 10, 1945, three

of said directors were employees of Warner; after that date only two were such employees.

Request No. 24. Only one of said directors, namely Waddill Catchings, was not on Warner's pay roll.

A. Not true; the directors Waddill Catchings, Morris Wolf, Charles S. Guggenheimer and John E. Bierwirth were not on Warner's payroll.

Request No. 25. Throughout 1945 Harry Warner and Jack Warner knew that each of the said seven directors who received compensation from Warner as hereinbefore described in previous requests and who sat on the Warner Board, was conscious of the fact [448] that opposition to the expressed views of the said Warner brothers on matters involved in the resolutions passed by the said Board on the 25th day of September, 1945, the 28th day of September, 1945, and the 23rd day of November, 1945, was fraught with danger to such director's private interests.

A. Not true. [449]

* * * * *

Request No. 29. Approximately 3 or 4 months before September 28, 1945, Harry Warner planned that an independent motion picture production company operated and controlled jointly by Milton Sperling and Joseph Bernhard would produce pictures in the [450] Warner studios.

A. Not true. The facts are that several months prior to September 28, 1945, Harry Warner conceived the idea that in view of the fact that Jack Warner was the only production head of Warner, that Warner should get some other competent per-

son connected with the organization in such manner that if Jack Warner should be unable to continue with his duties, the company would have available a competent and trained person to take his place. From this initial conception, by degrees and after much thought and many conferences, there was developed the idea which was finally put into effect of having an individual motion picture production company which should be operated and controlled by Milton Sperling and Joseph Bernhard and which would produce motion pictures at the Warner studios for Warner distribution.

Request No. 30. In the summer of 1945, Harry Warner and Jack Warner knew that Sperling was anticipating his discharge from military service in or about September of that year.

A. True.

Request No. 31. In the summer of 1945, Harry Warner and Jack Warner knew that Bernhard was [451] friendly with John S. Bierwirth, president of The New York Trust Company.

A. True. [452]

Request No. 32:

"Before and after August 4, 1945, Harry Warner and Jack Warner discussed said plan with Milton Sperling."

The answer is: "True."

Request No. 33:

"Before and after August 4, 1945, Harry Warner and Jack Warner discussed said plan with Joseph Bernhard."

The answer is: "True." * * * * * [453]

Request No. 37:

"In said discussions Harry Warner suggested to Bernhard, in substance, that he (Bernhard) try to influence John S. Bierwirth, president of The New York Trust Company, to approve the said bank loaning to an independent motion picture production company which [454] would be formed and owned equally by Bernhard and Sperling, on terms substantially like those contained in the agreement thereafter entered into between Warner, United and the said Trust Company on October 31, 1945, 50 per cent of the production costs of a series of motion pictures which would be produced by such independent company in the Warner studios."

The answer is: "Not true."

Request No. 39:

"Before August 4, 1945, Joseph Bernhard, acting in behalf of Warner, had been influential in procuring a loan or loans from The New York Trust Company to Warner."

The answer is: "True."

* * * * *

Request No. 41:

"Before August 4, 1945, Harry Warner and Jack Warner knew that Bernhard, acting in behalf of Warner, [455] had been influential in procuring a loan or loans from The New York Trust Company to Warner."

The answer is: "True."

* * * * *

Request No. 43:

"Before August 4, 1945, Bernhard told Harry

Warner in substance, that he (Bernhard) believed that he could procure The New York Trust Company to agree to loan an independent motion picture production company, which would be firmed and owned equally by Bernhard and Sperling, on terms substantially like those contained in the said agreement dated October 31, 1945, 50 per cent of the production cost of a series of motion pictures which said company would produce at the Warner studios."

The answer is: "True, except as to the terms referred to as contained in the agreement dated October 31, 1945, [456] as to which these answering defendant did not then know what, if any, terms would be contained in any agreement thereafter to be drawn, or what agreement or agreements if any, would be required to be drawn, and except that neither defendant can say positively that said statement was made either before or after August 4, 1945."

Request No. 44:

"Before August 4, 1945, Harry Warner and Jack Warner told Bernhard, in substance, that if he could procure The New York Trust Company to agree to loan to an independent motion picture production company which would be formed by and owned equally between him (Bernhard) and Sperling, on terms substantially like those contained in said agreement dated October 11, 1945, 50 per cent of the production cost of a series of motion pictures which such independent company would produce in the Warner studios, they (Harry and Jack War-

ner) would approve of Warner entering into an agreement with such an independent production company, whose terms would be substantially like those of the master agreement thereafter entered into between Warner and United."

The answer is: "True, as to Harry Warner, except the references [457] to the terms of an agreement dated October 31, 1945, as to which the situation is the same as that stated in response to request No. 43, and except that there was no reference to any terms dependent upon those of the master agreement referred to for the reason that at that time there was no knowledge on the part of anybody as to what those terms would ultimately be. As to defendant Jack Warner, the statement is untrue."

Request No. 45:

"On or about August 4, 1945, Harry Warner and Jack Warner knew that Sperling and Bernhard had agreed between themselves:

(a) To form an independent motion picture production company;

(b) That Sperling and Bernhard would each purchase 125 shares of the capital stock of the company so formed by them and pay $12,500 therefor."

The answer is: "True." [458]

* * * * *

Request No. 47:

"Prior to August 4, 1945, Harry Warner and Jack Warner knew that Sperling had not theretofore engaged in the business of independent pro-

duction of motion pictures' as that term is known and understood in the motion picture industry."

The answer is: "True."

Request No. 56: "Prior to August 4, 1945, Harry Warner and Jack Warner knew that Bernhard had not theretofore engaged in 'independent production of motion pictures' as that term is known and understood in the motion picture industry."

The answer is: "True."

Request No. 57:

"Prior to August 4, 1945, Harry Warner and Jack Warner knew that Bernhard had approached John S. Bierwirth, president of The New York Trust Company, with a view to obtaining a commitment from said Bierwirth that the said bank would enter into an agreement with Warner and an independent motion picture production [459] company, which would be formed and owned equally by Bernhard and Sperling, the terms of which agreement would be substantially like the terms of the agreement subsequently entered into between Warner, United and the said bank on October 31, 1945."

The answer is: "True, as to Harry Warner, except as to the references to the terms of an agreement of October 31, 1945, as to which said defendant refers to the statement made in response to request No. 43, and as to the provisions with respect to the master agreement, the terms of which were then not known to either of the parties; untrue as to defendant Jack Warner."

Request No. 58:

"Prior to August 4, 1945, Bernhard told Harry

Warner, in substance, that he (Bernhard) desired Warner to pay him $78,000 on severing his (Bernhard's) connection with Warner."

The answer is: "Not true."

Request No. 59:

"On or before September 11, 1945, Bernhard told Harry Warner and Jack Warner, in substance, that he had obtained a commitment from John S. Bierwirth, president of the New York Trust Company, that said bank [460] would make loans to United on terms substantially like those contained in the agreement which was subsequently entered into between said three parties and dated October 31, 1945."

The answer is: "As to Harry Warner, true; except as to the reference to the terms of the agreement of October 31, 1945, as to which the answer is the same as that made to request No. 43; not true as to Jack Warner."

Request No. 60:

"Before September 11, 1945, Harry Warner and Jack Warner knew that Sperling and Bernhard had entered into a stockholders agreement, which agreement is dated August 31, 1945."

The answer is: "True, except as to Harry Warner, that he did not know the terms of such agreement or its date; not true as to Jack Warner."

Mr. Levy: May I at this point call Mr. Williams' attention to the fact that the answer is somewhat unintelligible, probably due to an error on the part of the typist?

Mr. Williams: If there is any error, it is on my part.

Mr. Levy: The answer as it reads: "True, except as to Harry Warner"—it probably means true as to Harry Warner except that he did not know the terms of the agreement. [461]

Mr. Williams: That is correct.

Mr. Levy: Is that what you meant?

Mr. Williams: Yes.

The Court: May it be stipulated that the answer to Request No. 60, which appears on lines 26 through 28 on page 12 of Exhibit 110 may be amended to read:

"True, as to Harry Warner, except that he did not know the terms of such agreement or its date; not true as to Jack Warner"?

Mr. Williams: That is correct.

* * * * *

Mr. Levy: Request No. 61:

"On and before September 11, 1945, Harry Warner and Jack Warner knew that Bernhard had obtained a commitment from John S. Bierwirth, president of The New York Trust Company, to the effect that said bank would enter into an agreement with United and Warner, the terms of which agreement would be substantially like the terms of the agreement which was subsequently entered into between Warner, United, and the said Bank on October 31, 1945."

The answer is: [462] "True, except as to the reference as to the terms of an agreement of October 31, 1945, as to which they then knew nothing."

Request No. 62:

"Before the master agreement was drawn, the substance of its provisions was agreed upon in oral discussions between Harry Warner, Jack Warner, Milton Sperling, and Joseph Bernhard."

The answer is: "True." [463]

* * * * *

Mr. Levy: Then I shall re-read Request 63 and follow it with the answer thereto.

"Request No. 63. Prior to September 10, 1945, Harry Warner outlined to Herbert Freston, Esq., one of the attorneys for Warner, the substance of what he (Harry Warner) desired to be written into a proposed contract between Warner and United.

A. Not true; Harry Warner stated that Bernhard had caused United to be organized with Bernhard and Milton Sperling as stockholders and that said corporation would produce six pictures over a period of years for distribution by the Warner distributor. Warner told Freston what the distribution charge would be and that Price, Waterhouse & Co. was determining the overhead charge to the producer. Warner did not state the substance of what he desired written into the proposed contract but stated he and Bernhard had discussed only certain points to be covered by the agreement and asked Freston to contact Bernhard as to the points [464] discussed and then prepare the agreement as attorney for Warner, so as to be fair to both parties.

Request No. 64. On September 28, 1945, Harry Warner and Jack Warner knew the substance of

the terms which are contained in the master contract. A. True.

Request No. 65. The Thirty-First paragraph of the master contract provides:

'If the Producer shall borrow from any banking association a substantial part of the cost (that is, that part of such cost as the Producer is obligated to pay hereunder) of producing any photoplay herein provided for, the Producer shall notify the Company, in writing, to that effect.'

At the time the master contract was signed Harry Warner and Jack Warner knew that United, Sperling and Bernhard intended, as provided in the Thirty-first paragraph thereof, to borrow from The New York Trust Company that part of each picture's production cost as United was obligated to pay. A. True.

Request No. 66. At the time the master contract was signed, Harry Warner and Jack Warner knew that the total capital of United was $25,000; that [465] Sperling and Bernhard had each purchased 125 acres of the capital stock of said company for $12,500. A. True. * * * * *

Request No. 69. On September 11, 1945, Harry Warner and Jack Warner knew that Warner made United a cash loan for 'general purposes' in the sum of $50,000.

A. True, as to defendant Harry Warner; not true as to defendant Jack Warner.

Request No. 70. On September 11, 1945, Harry Warner and Jack Warner knew that Warner and United would enter into and execute an agreement

the substance of the terms of which would be that contained in the master contract subsequently signed by said parties on September 28, 1945. [466]

A. On September 11, 1945 Harry and Jack Warner believed and intended that Warner and United would enter into an agreement as described in this request; but, of course, they did not know that such agreement would be executed."

And I would call your Honor's attention to the fact that the answering defendants underscored the word "know" on line 7 of page 15 of this Exhibit 110 in evidence.

"Request No. 71. On September 11, 1945, Harry Warner and Jack Warner knew that after the said master contract would be signed by Warner and United, the same would be implemented by a contract between Warner, United and The New York Trust Company, the substance of the terms of which would be that contained in the contract subsequently entered into between the said three parties on October 31, 1945.

A. Not true.

Request No. 72. Subdivision 4½ of Paragraph Seventh (a) of the master contract provides:

'Out of the gross receipts retained by the Company it shall pay to the Producer, by way of reimbursement, a sum equal to all costs and expenses paid or incurred by the Producer in the production of each of the photoplays herein provided for, which costs of the Producer shall include a [467] reasonable allowance for its operating and general overhead in connection with the production of each

such photoplay. Such overhead shall include such reasonable executive salaries as the Producer shall pay to Joseph Bernhard and Milton Sperling and other production employees; provided, however, that any part of such salaries which may properly be charged to a picture as a "direct charge" shall not be included in computing the Producer's general overhead.'

Before the master contract was signed, neither Harry Warner nor Jack Warner indicated to Sperling or Bernhard what he (Harry Warner and Jack Warner) considered a 'reasonable allowance' for United's 'operating and general overhead', above referred to. A. True.

Request No. 73. Before the master contract was signed, neither Harry Warner nor Jack Warner indicated to Sperling or Bernhard what salaries he would consider 'reasonable executive salaries.'

A. Harry and Jack Warner both indicated to Sperling and Bernhard the salaries they would consider 'reasonable executive salaries' but as to whether this matter was discussed before or [468] after the master contract was signed, neither defendant can state.

Request No. 74. Before and at the time of the execution of the master contract Harry and Jack Warner knew that never before had Warner entered into a contract with an independent producer which gave the producer the same benefits and advantages as provided in said master contract.

A. Not true. Each contract entered into between Warner and an independent producer gave to War-

ner and such producer certain benefits and advantages which in many particulars were identical and in general were the same or similar to those provided in the master contract but which in many details differed from contract to contract. The question of whether the provisions of each contract gave to the producer benefits or advantages which were the same or less or similar to those provided in the master contract is a matter of opinion and a matter which can only be determined by the ultimate results of each contract. For that reason, these defendants are unable to state categorically as to any contract whether it gave the producer the same, greater, lesser or similar benefits and advantages to those given other producers under other contracts. * * * * * * [469]

Request 76. Before and at the time of the execution of the master contract, Harry Warner and Jack Warner knew that Warner had never before entered into a contract with an independent producer, by the terms of which contract Warner incurred the same risks as it incurred by the master contract.

A. Not true. Defendants repeat the answer to request No. 74 as the answer to this request. In addition thereto, it should [470] be pointed out that every contract with an independent producer and every undertaking by Warner to make feature motion pictures involves numerous risks to Warner to the full extent and in many cases beyond the total production cost of said picture. The amount and character of such risks to Warner to the full

extent and in many cases beyond the total production cost of said picture. The amount and character of such risks are determined by numerous circumstances, including general business conditions, current attitude of the public towards entertainment, type of picture involved, the story, the stars, the integrity, character and ability of the producer and director, and numerous other matters, too many to enumerate, all of which must be weighed to determine the extent and seriousness of the risks involved. A weighing of all such factors and the determination of whether such picture should be produced is a matter of business judgment; and the question of whether the incurring of such risks is justifiable from a business standpoint is ultimately proved only from the results obtained. In any event, the making of a contract with any independent producer as well as the making of any picture by Warner itself involves [471] risks which are broadly like and similar to those incurred by the master contract. * * * * * [472]

Request No. 87:

"In or about November, 1945, Harry Warner nominated John S. Bierwirth as a Warner director to fill the vacancy created by Bernhard's resignation as a director."

The answer is: "True."

Request No. 88: [477]

"In November, 1945, John S. Bierwirth was elected a Warner director."

The answer is: "True."

Request No. 89:

"On February 15, 1946, Harry Warner knew that Warner made a cash loan to United for 'general purposes' in the sum of $100,000."

The answer is: "True."

Request No. 90:

"On February 15, 1946, Harry Warner and Jack Warner knew that the master contract contained no provision for 'general purposes' loans by Warner to United."

The answer is: "True." * * * * * [478]

Request No. 96. On September 18, 1946, Harry Warner and Jack Warner knew that Bernhard sold his interest in United to Sperling for $400,000 cash.

A. True.

Request No. 97. On September 18, 1946, Harry Warner and Jack Warner knew that Sperling had borrowed $400,000 from The New York Trust Company for the purpose of purchasing Bernhard's stock in United. A. True.

Request No. 98. On September 18, 1946, Harry Warner and Jack Warner knew that Mrs. Betty Sperling, Harry Warner's daughter, had deposited with said New York Trust Company collateral owned by her for the purpose of securing the said loan. A. True.

Request No. 99. In or about December, 1946, Harry Warner and Jack Warner knew that Sperling assigned 62 shares of United capital stock to The Title Insurance and Trust Company of Los Angeles as trustee, to be held in trust for the benefit

of the minor children of Milton and Betty Sperling.

A. True. [481]

"Request No. 100. Since November 7, 1945, Harry Warner and Jack Warner knew that the 'budget' of each of the pictures which United produced under the master contract and its amendments was prepared by United.

A. Not true as to Harry Warner; true as to Jack Warner.

* * * * *

Request No. 104. Before December 6, 1947, Sperling [482] told Harry Warner that he (Sperling) was unwilling to proceed with the production of the three pictures which then remained unproduced.

A. True only to the extent that he was temporarily unwilling to proceed.

Request No. 105. On December 6, 1947 Warner and United entered into an amendment to the master contract bearing that date.

A. True."

That amendment, if the court please, is Exhibit No. 4 in evidence.

Mr. Williams: Exhibit 4.

The Court: Stipulated?

Mr. Williams: So stipulated, your Honor.

Mr. Levy: "Request No. 106. On or before December 6, 1947 Sperling, acting on behalf of United, and Harry Warner and Jack Warner acting on behalf of Warner, orally agreed on the substance of the terms of the said amendment.

A. True.

Request No. 107. On December 6, 1947 Harry

Warner and Jack Warner knew the substance of the terms of the said amendment.

A. True.

Request No. 108. On December 9, 1947 Warner [483-484] and United entered into a further amendment to the master contract. A. True.

Request No. 109. On December 9, 1947 Harry Warner and Jack Warner knew the substance of the terms of the amendment bearing that date.

A. True."

The amendment referred to in the two previous requests is Exhibit No. 5 in evidence.

Mr. Williams: So stipulated, your Honor.

Mr. Levy: "Request No. 110. On or before December 6, 1947 Harry Warner and Jack Warner knew that Warner had paid Bernhard the sum of $78,000 as 'severance pay' in installments of $3,000 commencing with the week of November 7, 1945.

A. True.

Request No. 111. On or before December 6, 1947 Harry Warner and Jack Warner knew that the actual production cost of 'Clock and Dagger' exceeded the budgeted cost thereof by over a quarter of a million dollars.

A. Not true as to Harry Warner; true as to Jack Warner. [485]

* * * * *

Request No. 113. On December 6, 1947 Harry Warner knew that the actual production cost of 'My Girl Tisa' exceeded the budgeted cost thereof by over $100,000. A. Not true.

* * * * *

Request No. 116. On and before December 6, [486] 1947, Harry Warner and Jack Warner knew that United had borrowed $814,090 from The New York Trust Company in connection with the production of 'My Girl Tisa.'

A. True in part; they knew that United had borrowed from The New York Trust Company, but not the amount. [487]

* * * * *

Request No. 118:

"Before December 6, 1947, Harry Warner and Jack Warner knew that percentagewise Warner's overhead for the period commencing March 3, 1946, to March 1, 1947, was greater than Warner's overhead during the period commencing February 24, 1944, to February 24, 1945."

The answer is: "True."

Request No. 119:

"Before December 6, 1947, Harry Warner and Jack Warner knew that percentagewise Warner's overhead during the year 1947 was greater than Warner's overhead during the period commencing February 24, 1944, to February 24, 1945."

The answer is: "True." [488]

Request No. 132. "On or before December 6, 1947 Harry Warner and Jack Warner knew that United had theretofore delivered to Warner a statement of United's overhead for the year 1946.

A. Not true as to defendant Harry Warner; true as to Jack Warner.

Request No. 133. On or before December 6, 1947 Harry Warner and Jack Warner knew that said

statement disclosed that United overhead, allocated to the production cost of the two pictures completed by United during that year, namely 'Cloak and Dagger' and 'Pursued,' was in excess of $200,000. [494]

A. Not true as to defendant Harry Warner; true as to Jack Warner.

Request No. 134. On or before December 6, 1947 Harry Warner and Jack Warner knew that a sum in excess of $200,000, representing United overhead incurred by United during 1946 was allocated by United to the production cost of the pictures 'Cloak and Dagger' and 'Pursued,' and made a part of the total production cost of said pictures.

A. Not true as to defendant Harry Warner; true as to Jack Warner.

Request No. 135. On or before December 6, 1947 Harry Warner and Jack Warner knew that included in United's overhead, referred to in requests Nos. 132 to 134 inclusive, was:

(a) An item in excess of $50,000 relating to stories and/or story rights and/or scenarios purchased or otherwise acquired by United which were not related to the pictures 'Clock and Dagger' and 'Pursued' and were not used by United but which were abandoned and written off by United as worthless.

(b) An item of $25,000 paid by United to Prinzmetal & Grant, attorneys; that said attorneys had rendered no legal services therefor; that said [495] $25,000 was paid by United to said attorneys as a commission in connection with United's obtaining

the services of Gary Cooper for 'Cloak and Dagger.'

(c) An item in excess of $20,000 paid by United to Donald Hyde for services performed by him as an assistant to Sperling, and that Hyde, as such assistant, had rendered services in connection with the production of 'Cloak and Dagger' and 'Pursued.'

* * * * *

"(d) An item in excess of $20,000 paid to Oliver B. Schwab and Schwab & Shapiro, attorneys for United; and that said attorneys had rendered legal services in connection with the production of said pictures.

(e) An item of $7500 to Hemisphere's attorney [496] and that such attorney had rendered legal services in connection with the production of 'Pursued.'

(f) An item in excess of $22,000 paid to Bernhard for services as an 'executive' of United.

A. Not true as to defendant Harry Warner, true as to Jack Warner except as to the statement concerning legal services of Printzmetal & Grant. [497]

* * * * *

Request No. 137:

"On December 6, 1947, Harry Warner and Jack Warner knew that Warner had advanced in excess of $800,000 as its share of the production cost of My Girl Tisa."

The answer is:

"Not true as to defendant Harry Warner; true as to Jack Warner."

Request No. 138:

"On December 6, 1947, Harry Warner and Jack

Warner knew that United had produced and completed the production My Girl Tisa; that the said picture had theretofore been exhibited to the military forces of the United States."

The answer is:

"Not true as to defendant Harry Warner; true as to Jack Warner."

* * * * *

Request No. 140:

"On and before August 1, 1948, Harry Warner and [498] Jack Warner knew that in all probability Warner would suffer a production loss in connection with My Girl Tisa."

The answer is: "Not true."

Request No. 141:

"On August 1, 1948, Harry Warner and Jack Warner knew that Warner would suffer a production loss in connection with My Girl Tisa."

The answer is: "Not true."

Request No. 142:

"On and before July 21, 1950, Harry Warner and Jack Warner knew that Warner had suffered a production loss in connection with My Girl Tisa."

The answer is:

"If by 'suffered a production loss' is meant that the rentals from the film, less proper deductions, had not equaled the cost of production, the answer is true as to Jack Warner, not true as to Harry Warner."

Request No. 143:

"On July 21, 1950, Harry Warner and Jack Warner knew that Warner entered into an amendment

to the master contract which is dated July 21, 1950."

The answer is: "True." [499]

That amendment, if your Honor please, is in evidence as Exhibit No. 7.

Request No. 144:

"At the time said amendment was executed, Harry Warner and Jack Warner knew the substance of its terms."

The answer is: "True."

Request No. 145:

"On July 21, 1950, Harry Warner and Jack Warner knew that in 1948 United had produced South of St. Louis as an 'additional' picture, and that in 1949 United had produced Three Secrets as an 'additional' picture."

The answer is: "True."

* * * * *

Request No. 152:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that percentagewise Warner's overhead for the period commencing February 29, 1948, to February 26, 1949, was greater than Warner's overhead during the period commencing February 24, 1944, to February 24, 1945."

The answer is: "True."

Request No. 153:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that percentagewise Warner's overhead during the period commencing February 24, 1949, and terminating February 24, 1950, was greater than [502] Warner overhead during the

period commencing February 24, 1944, to February 24, 1945."

The answer is: "True."

Request No. 154:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that the actual production cost of the picture South of St. Louis exceeded the budgeted cost thereof by approximately $150,000."

The answer is:

"Not true as to Harry Warner: true as to Jack Warner."

Request No. 155:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that United had theretofore delivered to Warner a statement of United's overhead for the year 1947."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 156:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that said statement disclosed that United overhead, allocated to the production cost of My Girl Tisa, which was completed by United during 1947, was in excess of $200,000."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner." [503]

Request No. 157:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that a sum in excess of $200,000, representing overhead incurred by United during

1947, had been allocated by United to the production cost of My Girl Tisa, and made a part of the total production cost of that picture."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 158:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that included in United's overhead, referred to in requests numbers 156 and 157, was:

"(a) An item in excess of $40,000 relating to stories and/or story rights and/or scenarios purchased or otherwise acquired by United which were not related to the picture My Girl Tisa and were not used by United but were abandoned and written off by United as worthless;

"(b) An item in excess of $20,000 paid to Sperling for services rendered by him in the capacity of an 'executive' to United;

"(c) An item in excess of $35,000 paid to Donald Hyde for services rendered by him as an assistant to Sperling in the production of said picture; [504]

"(d) An item in excess of $18,000 paid to United's attorneys for services rendered by them in connection with the production of said picture;

"(e) An item in excess of $10,000 representing salaries paid to actors who rendered no services in consideration of said money paid them."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 159:

"On July 21, 1950, Harry Warner and Jack Warner knew that United had theretofore delivered to Warner a statement of United's overhead for the year 1948."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 160:

"On July 21, 1950, Harry Warner and Jack Warner knew that said statement disclosed United's overhead allocated to the production cost of the picture South of St. Louis was in excess of $100,000."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 161:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that a sum in excess of $100,000 representing overhead incurred by United in 1948 had been [505] allocated by United to the production cost of South of St. Louis, and made a part of the total production cost of that picture."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 162:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that included in United's overhead referred to in request Numbers 160 and 161, was:

"(a) An item in excess of $18,000 paid to Sperling for services rendered in his capacity as a United 'executive';

"(b) An item in excess of $30,000 paid to Donald Hyde, who rendered services as an assistant to Sperling in the production of said picture;

"(c) An item in excess of $13,000 paid to J. C. Yoss who rendered services as an accountant in connection with the production of said picture;

"(d) An item in excess of $13,000 paid to United's attorneys who rendered services in connection with the production of said picture."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner." [506]

* * * * *

Request No. 168. On August 12, 1952, Harry Warner knew that Warner had entered into an amendment to the master contract which was dated that day. A. True." [508]

That amendment, if the court please, is attached to Exhibit 107 and is contained in Schedule H of Exhibit 107 in evidence.

"Request No. 169. At the time said amendment was executed, Harry Warner and Jack Warner knew the substance of its terms.

A. True.

Request No. 170. On August 12, 1952, Harry Warner and Jack Warner knew that no picture had been produced by United during 1952 and up to August 12 of that year. A. True.

Request No. 171. On August 12, 1952, Harry

Warner and Jack Warner knew that throughout the year of 1952 and up to said day, United had not engaged in principal photography on any picture.

A. True. * * * * * [509]

Request No. 175. On or before August 12, 1952, Harry Warner and Jack Warner knew that during 1952 and up to said date, United had paid Sperling $1500 a week for services rendered and expenses incurred by Sperling. A. True.

Request No. 176. On or before August 12, 1952, Harry Warner and Jack Warner knew that percentagewise Warner's overhead for the period commencing February 26, 1950 and terminating February 24, 1951 was greater than Warner's overhead during the period commencing February 24, 1944 to February 24, 1945. A. True.

Request No. 177. On or before August 12, 1952, Harry Warner and Jack Warner knew that percentagewise [510] Warner's overhead for the period commencing February 25, 1951 and terminating March 1, 1952 was greater than Warner's overhead during the period commencing February 24, 1944 to February 24, 1945. A. True.

Request No. 178. On August 12, 1952, Harry Warner and Jack Warner knew that in 1951 United produced 'Distant Drums' and 'Retreat, Hell!'

A. True.

Request No. 179. On August 12, 1952, Harry Warner and Jack Warner knew that the actual production cost of the picture 'Distant Drums' exceeded the budgeted cost thereof by over a quarter of a million dollars, and that the actual production

cost of the picture 'Retreat, Hell!' exceeded the budgeted cost of that picture by over $150,000.

A. Not true as to Harry Warner; true as to Jack Warner. [511]

* * * * *

Request No. 188. Since September 18, 1946, Harry Warner and Jack Warner have known that United's business policies were determined solely by Sperling. A. True. [514]

* * * * *

Request No. 190. Since September 18, 1946 Harry Warner and Jack Warner knew that whether United should or would abandon and write off a literary property purchased or acquired by United for the purpose of making a motion picture was determined solely by Sperling. A. True.

Request No. 191. Since September 18, 1946, Harry Warner and Jack Warner have known that whether United should sell or otherwise dispose of a literary property purchased or acquired by United for the purpose of making a motion picture was determined solely by Sperling.

A. Not true.

Request No. 192. Sub-paragraph 6 of paragraph Seventh (a) of the master contract provides as follows:

'The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are incurred in [515] connection with such production

program, the Company shall, weekly, on proper vouchers or billing from the Producer, reimburse the producer for a sum equal to one-half of such obligations, * * *'

Since September 18, 1946, Harry Warner and Jack Warner have known that any and all contractual obligations incurred by United, and any and all commitments made by United, which are referred to in the above quoted paragraph, were determined to be so incurred and were determined to be so made solely by Sperling.

A. True, except for the control exercised by Warner's right to approve or disapprove the budget of each picture.

Request No. 193. Since September 18, 1946, Harry Warner and Jack Warner have known that the amount of compensation paid by United to Sperling for services rendered by him was determined solely by Sperling.

A. True, except for the limitation contained in the master contract that such compensation must be 'reasonable.'

Request No. 194. Since September 18, 1946, Harry Warner and Jack Warner have known that the [516] amount of compensation which United should or would pay to 'production employees.' referred to in sub-paragraph 4½ of paragraph Seventh (a) of the master contract, and quoted herein on p. 12½, line 13, was determined solely by Sperling.

A. True.

Request No. 195. Since September 18, 1946, Harry Warner and Jack Warner have known that the

compensation which United should or would pay to any and all persons in United's employ was determined solely by Sperling. A. True.

Request 196. Since September 18, 1946, Harry Warner and Jack Warner have known that the price of any item of property purchased or acquired by United in the course of the production of pictures was determined solely by Sperling.

A. True.

Request No. 197. Since December 7, 1946, Harry Warner and Jack Warner have known"——

That is an error.

Mr. Williams: It is pointed out in the answer.

Mr. Levy: Yes. It should be "December 6, 1947" instead of "December 7, 1946," and it is pointed out in the answer, your Honor. May I at this time move to correct Request No. [517] 197 so as to read: "Since December 6, 1947"?

Mr. Williams: Mr. Levy, may I suggest that if you leave it the way it is now, it is perfectly clear. If you amend it now, then you have got to change the answer, too, and that makes it that much more difficult.

Mr. Levy: Oh.

The Court: You have the commitment you seek, do you not?

Mr. Levy: Yes, your Honor. And I shall read it. The request, then, is:

Request No. 197. "Since December 7, 1946, Harry Warner and Jack Warner have known that whether a picture thereafter produced by United should or would be a 'remaining original' picture or an 'addi-

tional' picture was determined solely by Sperling.

A. Not true, since December 7, 1946, but it is true since December 6, 1947.

Request No. 198. Since September 18, 1946, Harry Warner and Jack Warner have known that the dates upon which United would pay its obligations to Warner, in connection with facilities made available to United by Warner in the making of 'original' pictures, was determined solely by Sperling.

"A. Not true. [519]

* * * * *

Mr. Levy: I offer in evidence Exhibit 111, being a document entitled "Answers by Defendant Warner Bros. Pictures, Inc. to Request for Admissions Dated March 30, 1953."

* * * * *

(Plaintiff's Exhibit No. 111 for identification was thereupon received in evidence.)

Mr. Levy: Request No. 1:

"Meetings of the Warner Board of Directors are held in New York City. Albert Warner customarily presides at such meetings, except on those occasions when Harry Warner is present.

"A. True."

Request No. 2:

"No stenographic notes are taken of the proceedings held at Board meetings. Minutes are made and kept. [523] "A. True."

Request No. 3:

"The collective opinion of Harry, Jack, and Albert Warner on matters presented at Board meetings and the action desired by them to be taken

thereon are voiced by the generally presiding Albert Warner.

"A. True in part; not true in part. If the Warner Brothers are in accord, their views are expressed at board meetings either by Harry Warner or Albert Warner. Sometimes they are not in agreement, in which case those present express their several views. Sometimes matters are brought before the board as to which they have not theretofore formed an opinion, in which case each expresses his own view. Never do any of the brothers express a personal desire as to what action of the board should be."

Request No: 4:

"At a special meeting of the Warner Board held on September 25, 1945, the following resolution was unanimously adopted:

" 'Resolved: That the officers of the Corporation be authorized to terminate the employment agreement of Joseph Bernhard with the mutual consent of Mr. Bernhard and the Corporation, such termination to be effective on November [524] 7, 1945, and that Mr. Bernhard be paid the sum of Seventy-eight Thousand ($78,000) Dollars as severance pay, such sum to be payable in twelve (12) monthly installments commencing on December 1, 1945.' "

Mr. Williams: Incidentally, the minutes from which that excerpt has been taken have already been marked in evidence in this case, I believe. I think it might be of assistance if we indicated the exhibit number.

Mr. Levy: Yes; I was about to say, your Honor,

that the resolution which I had read is from Exhibit 17 in evidence.

The Court: So stipulated?

Mr. Williams: So stipulated, your Honor.

Mr. Levy: The request proceeds as follows:

"Before the Board voted on the above resolution, Albert Warner, who presided at said meeting, stated, among other things and in substance:

(a) That Bernhard and Sperling, Harry Warner's son-in-law, had organized a motion picture company, namely, United;

(b) That United was about to embark on the making of a series of pictures at the Warner studios, under a contract with Warner which was being prepared, the substance of which contract [525] had been agreed upon between Harry and Jack Warner, on behalf of Warner, and by Bernhard and Sperling, on behalf of United.

A. True as to the fact and the wording of the resolution quoted; true that before the board voted on said resolution, Albert Warner stated in substance that Bernhard and Milton Sperling, Harry Warner's son-in-law, were to join in United States Pictures, which would engage in the production of motion pictures to be distributed by Warner Bros. Otherwise, not true."

Request No. 5:

"Before the Warner Board voted on the said resolution dated September 25, 1945, Albert Warner told the directors present, among other things and in substance, that he and Harry and Jack Warner desired the adoption of the said resolution.

A. Not true." [526]

* * * * *

Request No. 12. The first picture, namely 'Cloak and Dagger', was photographed and completed in 1946 and has been exhibited since August of 1946.

A. True.

Request No. 13. The second picture, namely 'Pursued' was photographed and completed in 1946 and has been exhibited since January 1947.

A. True in part, except that said picture was first exhibited March 8, 1947.

Request No. 14. The third picture, namely 'My Girl Tisa', was photographed and completed in 1947 and has been exhibited since November, 1947.

A. True, except that the first exhibition of said picture was February 7, 1948.

Request No. 15. The fourth picture, namely [533] 'South of St. Louis', was photographed and completed in 1948 and has been exhibited since January of 1949.

A. True, except that the first exhibition of said picture was March 12, 1949.

Request No. 16. The fifth picture, namely, 'Three Secrets', was photographed and completed in 1949 and has been exhibited since the early part of 1950.

A. True, except that said picture was first exhibited October 14, 1950.

Request No. 17. The sixth picture, namely 'The Enforcer' was photographed and completed in 1950 and has been exhibited since January of 1951.

A. True, except that said picture was first exhibited February 24, 1951.

Request No. 18. The seventh picture, namely 'Distant Drums', was photographed and completed in 1951 and has been exhibited since December of 1951.

A. True.

Request No. 19. The eighth picture, namely 'Retreat, Hell', was photographed and completed in 1951 and has been exhibited since February of 1952. [534] "A. True.

Request No. 20. United did not photograph any pictures in 1952.

A. True." [535]

Request No. 21:

"The ninth picture, namely Blowing Wild, is presently in the process of being photographed. Principal photography thereon was begin in February of 1953. A. True." [536]

* * * * *

Request No. 30:

"Warner paid Bernhard Seventy-eight thousand ($78,000) Dollars in installments of Three Thousand ($3,000) Dollars a week, commencing December 1, 1945."

Mr. Williams: If your Honor please, may I state in this connection, although I waive the objection to that question, I do not waive the point that the element of paying Bernhard severance pay of $78,000 is within the issues of this case as such.

My view is, if this has any relevancy or admissibility, it is only in connection with the allegations of the complaint to the effect that contracts were made for the purpose of enriching the son-in-law of Harry Warner and to the detriment of Warner

Brothers Pictures, Inc. But I do not concede that this particular point is an issue in the case as such.

Mr. Levy: The answer is: "True." [540]

* * * * *

Mr. Levy: I shall start again with Request 31:

"At no meeting of the stockholders of Warner were the stockholders advised of the following:

"(a) The substance of the master contract and/or its amendments. "A. Not true.

"(b) The substance of the contracts entered into between Warner and United and The New York Trust Company. "A. Not true.

"(c) The substance of the agreement between United and Hemisphere Films, Inc., dated May 20, 1946. "A. True.

"(d) That Milton Sperling was Harry Warner's son-in-law. "A. Not true.

"(e) That Sperling owned 50 per cent of United's outstanding capital stock, between September 28, 1945, and September 18, 1946. "A. True.

"(f) That on September 18, 1946, Sperling acquired the remaining 50 per cent of United's outstanding stock. "A. True.

"(g) That, for the purpose of acquiring the remaining 50 per cent of United's capital stock, Sperling personally borrowed Four Hundred Thousand ($400,000) Dollars from The New York Trust Company. [542] "A. True.

"(h) That on or about September 16, 1946, Mrs. Betty Sperling, the wife of Milton Sperling and the daughter of Harry Warner, deposited certain stock, owned by her, of Warner Bros. Pictures with

the New York Trust Company as security for the repayment of the said loan. A. "True.

"(i) That, since December, 1946, Sperling has owned all the outstanding capital stock of United, with the exception of 62 shares. "A. True.

"(j) That, since December 23, 1946, said 62 shares have been held by the Title Insurance and Trust Company of Los Angeles, California, as Trustee, for the benefit of the minor children of Milton and Betty Sperling, which children are Harry Warner's grandchildren. "A. True." [543]

* * * * *

This exhibit, if the court please, is dated April 6, 1953. It is verified by Roy J. Obringer on the 3rd day of April, 1953.

I proceed, your Honor, to Exhibit 112 which I offer in evidence.

* * * * *

(The document was thereupon marked Plaintiff's Exhibit No. 112 and received in evidence.)

Mr. Levy: This exhibit contains a series of requests for admissions addressed to the defendant Milton Sperling. [547]

* * * * *

Request No. 4. Beginning with the autumn of 1934 and up to and including part of 1939, Sperling was employed as a writer, first by Fox Films and thereafter by its successor, 20th Century Fox. A. True.

Request No. 5. In 1939, Sperling's status at 20th Century Fox was changed to that of an employee producer. A. True.

Request No. 6. In 1939, Sperling was married to Miss Betty Warner, the daughter of Harry Warner.

A. True.

Request No. 7. The actual production of each of the pictures made by 20th Century Fox, in the making of which Milton Sperling was employed to act and did act as a producer, was not within his exclusive control.

A. True in part, the fact being that as to those pictures of which the defendant was the [548] producer, this defendant exercised the exclusive control customarily exercised by producers at said studio. All producers and all employees were subject to the studio head.

Request No. 8. The subject matter, the preparation of the screen play, the cutting and editing of each picture in the making of which Milton Sperling was employed by 20th Century Fox as a producer, were not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 9. The selection of the story upon which each such picture was based was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 10. The selection of the person who was to function as the director of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 11. The selection of the persons who

were to star or play the leading roles in each of such pictures was not within Sperling's exclusive control. [549]

"A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 12. The selection of the cast of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 13. The preparation of the budget for each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 14. The compensation to be paid to the director and to members of the cast of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 15. The selection of the title of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 16. The cost of the items which entered into the production of each such picture [550] both before and after the commencement of principal photography thereof, was subject to the approval of an executive or executives of 20th Century Fox.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 17. As such producer, Milton Sperling was not authorized to purchase literary properties without first obtaining the approval of his employer. A. True.

Request No. 18. As such producer, Sperling was not authorized to employ writers to compose literary properties and/or develop screenplays without first obtaining the approval of his employer.

A. True.

Request No. 19. Between 1942 and September of 1945, Sperling was in the military service.

A. True.

Request No. 20. Prior to the incorporation of United, Sperling discussed the proposed formation thereof with Harry Warner and Jack Warner and with Joseph Bernhard. A. True. [551]

Request No. 21. Prior to the incorporation of United, Milton Sperling discussed with Harry and Jack Warner and with Joseph Bernhard, terms of a proposed contract between United and Warner.

A. True to the extent that prior to the date of incorporation this defendant discussed terms in broad outline. [552]

* * * * *

Request No. 26:

"On or before September 10, 1945, Sperling knew that Bernhard had obtained a commitment from the said John S. Bierwirth, that the said Bank would make loans to United on terms substantially

like those contained in the said agreement dated October 31, 1945.

"A. True except that this defendant did not know on or before September 10, 1945, the terms which would be contained in the agreement to be drawn."

Request No. 27:

"On August 31, 1945, Sperling and Bernhard executed a stockholders agreement which is dated that day. "A. True."

Request No. 28:

"Before the master contract was drawn, the substance of its provisions was agreed upon in oral discussions between Harry Warner, Jack Warner, Sperling, and Bernhard.

"A. True except that this defendant did not participate in all of the discussions concerning the proposed agreement."

Request No. 29:

"At the time the master contract was signed, United's total capital consisted of $25,000 cash.

"A. True." [554]

* * * * *

Request No. 32:

"On September 11, 1945, Sperling, acting on behalf of United, borrowed $50,000 from Warner.

"A. True that said sum was borrowed, but said loan was made by Bernhard on behalf of United."

* * * * * [555]

Request No. 34:

"Subdivision 4½ of paragraph Seventh (a) of the master contract provides:

'Out of the gross receipts retained by the Company it shall pay to the Producer by way of reimbursement, a sum equal to all costs and expenses paid or incurred by the Producer in the production of each of the photoplays herein provided for, which costs of the Producer shall include a reasonable allowance for its operating and general overhead in connection with the production of each such photoplay. Such overhead shall include such reasonable executive salaries as the Producer shall pay to Joseph Bernhard and Milton Sperling and other production employees; provided, however, that any part of such salaries which may properly be charged to a picture as a 'direct charge' shall not be included in computing the Producer's general overhead.'

Before the master contract was signed, Sperling did not indicate to either Harry Warner or to Jack Warner, in words or substance, what salaries he (Sperling) would consider 'reasonable executive salaries.' [556]

Before the master contract was signed, Sperling did not indicate to either Harry Warner or Jack Warner, in words or substance, what allowance he considered 'a reasonable allowance' for United 'operating and general overhead.' "A. True."

Request No. 35:

"Before the master contract was signed, Sperling did not receive any communication from Warner which, in words or substance, set forth Warner's definition in terms of dollars, of the word 'reasonable' in the paragraph quoted above.

"A. True."

Request No. 36:

"The budget of each of the pictures which United has made under the master contract and its amendments was prepared by Sperling.

A. Not true. Said budgets were prepared by United and not solely by this defendant." [557]

* * * * *

Request No. 41: [558]

"Before September 18, 1946, Sperling authorized Stanleigh P. Friedman to draw a written contract of purchase and sale of said 125 shares; the price, $400,000 payable to Bernhard in cash simultaneously with the execution and delivery by Bernhard to Friedman of the said contract.

"A. True."

* * * * *

Request No. 43:

"On or before September 18, 1946, Sperling caused to be delivered to Friedman a cashier's check in the sum of $400,000 drawn on The New York Trust Company. "A. True."

Request No. 44:

"On September 18, 1946, Friedman delivered said cashier's check to Bernhard and the latter delivered a signed copy of said contract to Friedman together with his (Bernhard's) 125 share stock certificate, and his resignation as an officer and director of United. "A. True."

Request No. 45:

"Before September 18, 1946, Sperling borrowed

the [559] $400,000 referred to in the previous request from The New York Trust Company.

"A. True."

Request No. 46:

"Before September 18, 1946, Sperling executed his promissory note payable to The New York Trust Company in the sum of $400,000. "A. True."

Request No. 47:

"Mrs. Betty Sperling, the wife of Milton Sperling, was either a co-maker with Sperling of said promissory note or the same was endorsed by her.

"A. Not true."

Request No. 48:

"On or before September 18, 1946, Mrs. Betty Sperling delivered to said bank collateral security, to secure the payment of the said promissory note.

"A. True." [560]

* * * * *

The Court: You may proceed.

Mr. Levy: The last request that I have read, your Honor, is No. 48. I proceed now to the reading of No. 49.

"Request No. 49. On or soon after September 18, 1946, Sperling told Harry Warner and Jack Warner in substance:

(a) That he purchased Bernhard's stock interest in United for $400,000 cash;

(b) That he borrowed the money from The New York Trust Company;

(c) That he had executed his promissory note payable to the order of said bank;

(d) That Mrs. Betty Sperling had secured the

payment of the said note to the bank in the manner described in requests 45 to 48, both inclusive.

A. True except that with reference to subparagraph (d) of request 49, this defendant did not tell Harry Warner or Jack Warner that Mrs. Betty Sperling was a co-maker of said promissory note or that the same was endorsed by her.

Request No. 50. In December of 1946, Sperling transferred 62 of his shares of United capital stock to the Title Insurance and Trust [561] Company of Los Angeles as trustee, for the benefit of his and Mrs. Betty Sperling's minor children.

A. True.

Request No. 51. In or about December, 1946, Sperling told Harry Warner and Jack Warner that he had made the transfer of capital stock referred to in the previous request. A. True.

Request No. 52. Since September 18, 1946, Sperling has controlled the action of the Board of Directors of United. A. Not true.

Request No. 53. Since September 18, 1946, United's business policies were determined solely by Sperling. A. True.

Request No. 54. Since September 18, 1946, the persons who have composed United's Board of Directors were selected solely by Sperling.

A. Not true. The Directors have at all times since September 18, 1946 been elected by unanimous vote of all the stockholders.

Request No. 55."——

The Court: Before you proceed, am I correct in my recollection of the evidence that since Sep-

tember 18, 1946 [562] the sole stockholders in United have been the defendant Sperling and Title Insurance and Trust Company as trustee?

Mr. Levy: Yes, your Honor; that is the evidence.

"Request No. 55. Since September 18, 1946, the persons who have been officers of United were selected solely by Sperling.

A. Not true. The officers have at all times since September 18, 1946 been elected by the unanimous vote of the Board of Directors.

* * * * *

Request No. 58. Whether any literary property purchased by United or otherwise acquired by it should or would be abandoned and written off by United as worthless, was determined solely by [563] Sperling, since September 18, 1946.

A. True.

Request No. 59. Sub-paragraph 6 of paragraph Seventh (a) of the master contract provides as follows:

'The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are incurred in connection with such production program, the company shall, weekly, on proper vouchers or billing from the Producer, reimburse the Producer for a sum equal to one-half of such obligations, * * *'

Since September 18, 1946, any and all contractual obligations incurred by United and any and all com-

mitments made by United which are referred to in the above quoted paragraph were determined to be so incurred and were determined to be so made, solely by Sperling.

A. True except for Warner budget approval with respect to each picture.

Request No. 60. Since September 18, 1946, [564] the amount of compensation to be paid to Sperling for services rendered by him to United was determined solely by Sperling.

A. True but said determination was subject to the provisions of the master contract.

Request No. 61. Since September 18, 1946, the compensation which United would agree to pay to its accountants, attorneys and all other persons in United's employ, was determined solely by Sperling.

A. True.

Request No. 62. Since September 18, 1946, the price of any item of property that United agreed to purchase or otherwise acquire was determined solely by Sperling. A. True.

Request No. 63. Whether a picture to be produced by United under the terms of the master contract as amended would be produced by United as an 'original' or as an 'additional' picture was determined solely by Sperling, since December 6, 1947.

A. True.

Request No. 64. Paragraph 5 of the amendment to the master contract, dated December 6, 1947 provides: [565]

'You agree that, prior to the commencement of the principal photography of any of the photoplays

hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay, as hereinbefore referred to.'

The time, namely the day upon which (prior to the commencement of principal photography) United should or would advise Warner as to whether a picture proposed to be produced by United would be an 'original' or an 'additional' picture, was determined solely by Sperling, since December 6, 1947. A. True." [566]

* * * * *

Request No. 66:

"Before December 6, 1947, Sperling told Harry Warner that he (Sperling) was unwilling to proceed with the production of the pictures which then remained unproduced.

"A. True only to the extend that this defendant told Harry Warner that in view of uncertain business conditions he was temporarily unwilling to proceed." * * * * * [567]

Request No. 69:

"On or before December 9, 1947, Sperling, acting on behalf of United, and Harry Warner and/or Jack Warner, acting on behalf of Warner, orally agreed on the substance of the terms of the amendment to the master contract, which amendment is dated December 9, 1947. "A. True." [568]

* * * * *

The Court: December 9?

Mr. Levy: December 9.

The Court: Or December 6?

Mr. Levy: No; December 9. That is a further amendment to the master contract with reference to the picture Pursued.

The Court: You are referring now to which request?

Mr. Levy: I am referring now to Request No. 69.

The Court: That refers to what exhibit?

Mr. Levy: That refers to Exhibit No. 5 in evidence.

The Court: So stipulated?

Mr. Williams: So stipulated, your Honor. [569]

* * * * *

Request No. 71:

"Before July 20, 1950, Sperling, acting on behalf of United, and Harry Warner and/or Jack Warner, acting on behalf of Warner, orally agreed on the substance of the terms of the amendment to the master contract, dated July 20, 1950.

"A. True except that said agreement is dated July 21, 1950."

* * * * *

Request No. 73: [570]

"Before August 12, 1952, Sperling, acting on behalf of United, and Harry Warner and/or Jack Warner, acting on behalf of Warner, orally agreed on the substance of the terms of the amendment to the master contract, which amendment is dated August 12, 1952. "A. True."

Request No. 74:

"During Bernhard's connection with United, he

received approximately $44,000 as compensation for services rendered by him. "A. True."

Request No. 75:

"During Sperling's connection with United, he has received in excess of one-half million dollars as compensation for services rendered by him to United, and for expenses. "A. True."

This exhibit, if the court please, is dated April 2, 1953. It is verified by the defendant Milton Sperling on the 6th day of April, 1953, before a Vice Consul of the United States. [571]

* * * * *

(The document referred to, and marked Plaintiff's Exhibit 113, was received in evidence.)

* * * * *

The Court: You may proceed, if you desire——

Mr. Levy: Yes, your Honor.

The Court: ——with the reading of the deposition of Samuel Carlisle, Exhibit 113 in evidence.

Mr. Levy:

"Deposition of Samuel Carlisle, a Witness Called By and in Behalf of the Defendants, Taken Pursuant to Stipulation Dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 17th Day of May, 1951, Before Arnold Schubert, a Notary Public of the State of New York.

Appearances: Moss, Lyon & Dunn, Esqs., (310 West 7th Street, Los Angeles, California), Attorneys for the Plaintiff, By: Moroney, Ettinger & Pottish, Esqs., (271 Madison Avenue, New York, N. Y.) Sol Pottish, Esq., of Counsel. [575] Freston

& Files, Esqs., and Eugene D. Williams, Esq., (650 South Spring Street, Los Angeles 14, California) Attorneys for defendants Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, By: Eugene D. Williams, Esq., of Counsel and Friedman & Bareford, Esq., (11 West 42nd Street, New York, N. Y.) and Joseph D. Karp, Esq., By: Joseph D. Karp, Esq., of Counsel. [576]

* * * * *

SAMUEL CARLISLE

59 Stratford Road, Rockville Centre, New York, called as a witness by the defendants, being first duly sworn by Arnold Schubert, a Notary Public of the State of New York, testified as follows:

Direct Examination

Q. (By Mr. Williams): What is your business address, Mr. Carlisle?

A. 321 West 44th Street, New York.

Q. What is your occupation?

A. I am Controller and Assistant Treasurer of Warner Bros. Pictures, Inc.

Q. How long have you been in the employ of that company? A. 25 years.

Q. Have you been Controller at all times during that period? A. Yes.

Q. Have you also been Assistant Treasurer at all times during that period? A. Yes.

Q. Do you occupy any other office in Warner Bros. Pictures, Inc.?

A. I am a director of the company, a member of the Board of Directors. [577]

(Deposition of Samuel Carlisle.)

Q. How long have you been a member of the Board of Directors of the company?

A. Since 1934.

Q. And that is continuously up to and including the present time? A. That's right.

Q. Your office and place of business is at the headquarters of the company in New York City, is it? A. Yes.

Q. Has it been your custom throughout the years since you have been a director to regularly attend all meetings of the Board of Directors?

A. Yes, I have attended them regularly.

Q. Do you have any business connection other than your association with Warner Bros. Pictures, Inc.? A. None whatsoever.

Q. I desire to call your attention to a meeting of the Board of Directors of Warner Bros. Pictures, Inc., which was held on the 25th of September, 1945, and I ask you whether you were present at that meeting. A. Yes, I was.

* * * * * [578]

Q. (Continuing): That meeting was a meeting at which the resignation of Mr. Joseph Bernhard was submitted to the Board of Directors. Do you remember that?

A. He submitted his resignation, yes.

Q. At the time of the submission of the resignation, can you state whether there was or was not any statement made to the Board, or conversation among the members of the Board, as to the reason

(Deposition of Samuel Carlisle.)

why he was resigning from Warner Bros. Pictures, Inc.?

A. Yes, there was a question put by one of the members of the Board—I don't recall just which one it was—as to the reason, which was natural, and Mr. Albert Warner, who was Chairman of the meeting there, explained to him then about this U.S. Picture Company going to be organized.

Q. What did he say about it, as nearly as you can remember?

A. Well, he said that Milton Sperling was going to produce the pictures and they wanted to [579] have a business man in, and Joe Bernhard, with his wide experience in business, would make an ideal man for that job.

Q. Was that the substance of what was said with reference to what Bernhard was going to do, or the reason for his resignation at that time?

A. Yes, that was.

Q. Was there anything said at that time with reference to who Milton Sperling was?

A. Yes, the Major explained there that he was the son-in-law of H. M. Warner.

Q. Was anything said as to what his previous experience had been?

A. Yes. The Major gave some of his background.

Q. What, as nearly as you can remember?

A. He had produced several pictures successfully. I think he had been working for Fox for a number of years, 20th Century-Fox, that is.

Q. Now, have you, so far as you can remember

(Deposition of Samuel Carlisle.)

given the substance of what was said on both of those subjects at that time? A. Yes.

Q. Was there any dissent from the vote of the directors accepting the resignation?

A. No, there was none. [580]

Q. I now desire to call your attention to a meeting of the Board of Directors which was held just a few days later, on the 28th of September, 1945; and ask you whether you were present at that meeting? A. Yes, I was.

Q. I call your attention to the fact that at that meeting there was something that came up with reference to a contract between United States Pictures Inc., and Warner Bros. Pictures, Inc. Do you remember that occasion?

A. Yes. Major Warner introduced the matter and gave a little explanation, the same as he had done at the previous meeting, and turned it over to Stanleigh Friedman to explain the deal.

Q. Can you remember the substance of what Mr. Albert Warner said at that time, when he brought up the subject of this contract?

A. Well, it was somewhat the same as he had mentioned before.

Q. Well, just give us the substance of it, as well as you can.

A. That Milton Sperling had been a successful producer and that Joe Bernhard was going in with him because of his wide experience, and they [581] would make pictures to be distributed through Warner Bros. Pictures and its subsidiary companies.

(Deposition of Samuel Carlisle.)

Q. What was the substance of the statement made by Mr. Friedman at that time?

A. He had a synopsis of the contract before him there, and he read it off to the meeting there, stating the various terms of distribution and overhead being charged and the use of the Warner Brothers' facilities at the studio.

Q. Now, strain your memory and tell us, as nearly as you can remember, the substance of what he said about the various terms of that contract.

A. Well, they were to use various facilities at the studio, and the overhead was to be charged to them on the basis of a survey that had been made by Price, Waterhouse & Company prior to that time, and the distribution was substantially the same as in other contracts that had been made with other producers: 20 per cent for distribution in the United States, 25 per cent for England, and various rates for other countries.

Q. Was anything said as to the financing or the cost of making the pictures?

A. The cost of pictures, Warner Brothers [582] was to put up half, and U.S. Pictures was to put up the other half. They might do it by borrowing money from a bank, and if so, we would make arrangements there to pay the money over to the bank—that is, U.S. Pictures' share.

Q. U.S. Pictures' share?

A. I did not state before that the contract also provided for splitting the receipts after the costs had been recouped.

(Deposition of Samuel Carlisle.)

Q. In what proportion were the receipts to be split? A. Fifty-fifty.

Q. That is your recollection of the substance of what Mr. Friedman stated to the directors at that time?

A. Yes. There may be some other details that he went into. He had the contract before him.

Q. Was the contract itself physically present at that time in the room?

A. Yes, it was.

Q. I think you said also that Mr. Friedman had a synopsis before him?

A. Had a synopsis.

Q. Do you remember any of the directors having asked Mr. Friedman or anybody else any [583] questions about this contract, or the persons involved?

A. Yes, I remember, I believe it was Mr. Catchings, Mr. Waddill Catchings—I am not certain, but I believe it was Mr. Catchings that asked the question about whether U.S. Pictures could make pictures for distribution elsewhere and make those pictures on the Warner lot, and Mr. Friedman told him no, they couldn't make them for distribution elsewhere, they had to be made somewhere else.

Q. Were there any other questions that you remember, any other discussion that you remember?

A. Well, there was a lot of discussion, but that was the only really important point, I think, that was brought out.

(Deposition of Samuel Carlisle.)

Q. Do you remember the substance of any of the other discussion that was had at that time?

A. No, I do not.

Q. After this matter had been presented to the Board, did the Board act favorably upon it?

A. The Board passed the resolution.

Q. Was there any dissenting vote?

A. None. [584]

Q. I take it, then, that you voted for this resolution, as well as the one concerning the resignation of Mr. Bernhard on the previous meeting?

A. I did. I voted for both.

Q. Either before or during, or at any of those meetings at any time, did Mr. H. M. Warner, or Albert Warner, or any other person, make any statement to you with reference to the manner in in which you should vote on these resolutions?

A. No, no one ever did. At no time during my term as a director has anyone ever told me how to vote.

Q. Prior to the vote at the directors' meeting on the 28th of September, 1945, prior to going to that meeting, had you been informed as to the fact that negotiations were in progress concerning such a contract as this?

A. I am quite certain that I knew it.

Q. In your vote on these two matters, that is, the resignation of Mr. Bernhard and the execution of this contract, did you exercise your own judgment as to how you should vote?

A. I did, but we have to rely to a certain [585]

(Deposition of Samuel Carlisle.)

extent on the judgment of the executives in charge of these operations.

Q. In that regard, did you rely upon the judgment of those who had been negotiating this deal and Mr. Friedman, who explained it? Is that correct? A. Yes.

Q. Now I call your attention to the fact that there was a meeting of the Board of Directors of Warner Bros. Pictures, Inc. held on the 23rd of November, 1945, at which, according to the records of that meeting, you were present; do you remember being present at that time?

A. Yes, I was.

Q. That was a meeting which involved, among other things, the authorization or the ratification of a small change concerning the financing of pictures under this United States-Warner Brothers agreement. A. Yes, that's right.

Q. Was that matter explained at that meeting?

A. Yes, it was. [586]

Q. In connection with your vote, did any person suggest or request that you should vote any way on that matter? A. No.

Q. I call your attention to a meeting of the Board of Directors that was held on the 18th day of June, 1946, at which, according to the record, you were present, and I will say for your information, so that you may identify the meeting, this was a meeting at which, among other things, there was passed upon the matter of an amendment to the basic contract between Warner Bros. and United

(Deposition of Samuel Carlisle.)

States Pictures with reference to one play Pursued. Does that sufficiently identify the meeting for you? A. Yes.

Q. You were present at that meeting?

A. I was present.

Q. Prior to the meeting had you had some knowledge of the subject of this picture Pursued?

A. Yes, I did. The lawyers had spoken about it.

Q. State what your knowledge on the subject of this amendment concerning the picture Pursued was at the time of the meeting.

A. My recollection is that they wanted to get Teresa Wright to play in that picture Pursued, and the [587] only way they could get her in was on a sharing agreement. They organized this Hemisphere Corporation, and they had to amend that contract. It changed our percentage of the overhead upward, and it changed our percentage of the distribution upward from 20 to 25, of which we retained two and a half, and U.S. Pictures got the other two and a half.

Q. Was there any change made in the amount of the net profit—the distribution of the amount of the net profit?

A. Yes. Instead of the fifty-fifty, it was changed to one-third to Warner Bros. and one-third to United States Pictures.

Q. Now, had you, prior to this meeting of June 18th, knowing of these facts, given any consideration to what effect that would have on the amount of profit that might be gained by Warner Bros.,

(Deposition of Samuel Carlisle.)

assuming the picture had a normal distribution?

A. Yes. I worked up some figures, or had them worked up by some of my assistants here, assuming in one case that the picture grossed two and a half million, and in another case if it grossed three million.

Q. And what was, in round figures, the result of your computation in that regard? [588]

A. I have the statements here. On the three million basis, it showed that Warner's share would be $362,500, on the old basis, and on the new basis it would be $308,166. That is the producer's share to Warner Bros. Pictures, Inc; that doesn't take into consideration the increase in the distribution, which would be—I am wrong, it does take it in.

Q. You also figured it on a two and a half million gross basis, did you not?

A. Yes, we figured it on that basis.

Q. Was anything said to you as to the reason why it was advisable or necessary to make a deal with—what amounted to a three-way deal with a corporation known as Hemisphere Pictures, and United States Pictures, and Warner Bros. Pictures in regard to this particular picture?

A. Well, we were given to understand that that was the only basis on which they could get Teresa Wright in the picture, and I think Niven Busch—I think he had the story.

Q. Well, Niven Busch is a writer?

A. Yes.

(Deposition of Samuel Carlisle.)

Q. And Teresa Wright, is she a well-known motion picture star? A. Yes. [589]

Q. At any rate, you had that information and had checked up and had made the compilations of figures on the assumption that the picture would gross either two and a half or three million dollars before the meeting of the directors was held on June 18th, had you?

A. Yes—June 18th?

Q. Yes.

A. It must have been before that. I have no date on my——

Q. Well, now, let us get to the meeting of June 18th and perhaps that will refresh your recollection. Do you remember this matter being brought up before the directors on June 18, 1946?

A. Yes.

Q. Who presented the matter to the Board?

A. That was Mr. Friedman.

Q. Did he make a statement with reference to the matter at that time?

A. He did. Now, I do not recall definitely whether he presented these figures to the meeting.

Q. Well, let me ask you this: Do you remember that he did make a statement with reference to the conditions to be attached to this picture, to the making of this picture? A. Yes. [590]

Q. Do you remember the substance of what he said?

A. He explained to the Board there that while we got the lower share of the net profits of the

(Deposition of Samuel Carlisle.)

picture, we also got a higher share in the distribution and also a higher overhead, and there was also an allowance of $50,000 additional, which was provided in that contract that we got before the split.

Q. Was there anything said——

A. I say we got—that is, split between U. S. Pictures and Warner Bros. Pictures.

Q. Was there anything said at that time on the subject of whether Niven Busch would permit the story to be used or whether Teresa Wright would act in the picture on any terms other than this?

A. No. We were given to understand that that was the only conditions.

Q. Do you remember whether Mr. Friedman or you or somebody else presented to the Board the compilations which you had theretofore made?

A. No, I do not recall these figures being submitted to the Board. They may have been, but I do not recall.

Q. You just don't remember with reference to the matter one way or the other?

A. That's right. [591]

Q. When the vote was taken, did you vote favorably to this resolution? A. I did.

Q. At that time, or at any prior time, had any person made a statement to you with reference to which way you should vote on the matter?

A. No one ever suggested it.

Q. And your vote, when you did vote, was the exercise of your own judgment as to the propriety of the action, was it? A. Yes.

(Deposition of Samuel Carlisle.)

* * * * * [592]

Q. (By Mr. Williams): Now, Mr. Carlisle, you have examined this contract of December 6, 1947, which I have described, and I ask you whether on or about, or shortly after the date of this contract, the fact of it having been executed on behalf of Warner Bros, was brought to your attention as Controller of the company?

A. Yes, a copy of it was sent to me about the latter part of December, 1947.

Q. Thereafter did you take any action with reference [593] to having the auditing and accounting division of the company——

A. Yes, in the ordinary course the copy was passed through so as to set up the records there to furnish all the statements, et cetera.

Q. Did you observe as to what the terms in general of this contract of December 6, 1947, were?

A. In general it provided for making an additional four pictures on different terms. The overhead was to be charged on the same basis as we charge all other pictures at the studio produced for our own use. The split of the profits after we had recouped our cost was increased from 50 to 80 per cent for Warner Bros. and reduced from 50 to 20 per cent for U.S. Pictures. I do not recall if there were any other changes.

Q. Do you remember if there was any change with reference to the distribution fee?

A. Yes. That was changed from 20 to 25 per cent.

(Deposition of Samuel Carlisle.)

Q. That was for domestic distribution?

A. For domestic, and the foreign was upped also. I don't recall just now.

Q. Do you remember whether there was any change with reference to the cost of production of the pictures?

A. The cost of production was to be entirely financed by Warner Bros. Pictures. [594]

Q. Whereas, under the previous one, it was fifty per cent? A. Fifty-fifty.

Q. You then became aware of those changes through reading a copy of this contract, which was sent to you at about the time the contract was executed? A. Yes.

Q. I call your attention, Mr. Carlisle, to a meeting of the Board of Directors of Warner Bros. Pictures, Inc., held on the 17th of August, 1950, at which, according to the record of the meeting, you were present, and which considered, among other things, the matter of the contract between United States Pictures and Warner Brothers. Do you remember having been present at that meeting?

A. Yes, I do.

Q. I will ask you whether, in the meantime and shortly before that meeting, there had been brought to your attention the fact that it was contemplated that there should be another amendment to the basic United States Pictures-Warner Bros. contract providing for additional pictures?

A. I had heard that, yes.

Q. At the time of the meeting of the 17th of

(Deposition of Samuel Carlisle.)

August, 1950, at the meeting of the directors, did any [595] person bring that matter up before the directors?

A. Yes, I believe it was Mr. Bareford, Harold S. Bareford.

Q. Mr. Bareford is not a director of the company, is he?

A. Not of Warner Bros. Pictures, Inc.

Q. But he was present at the meeting?

A. He was present at the meeting. He usually is present.

Q. And he is one of the attorneys for Warner Bros. and also an Assistant Secretary?

A. He is an Assistant Secretary.

Q. Will you state what, in substance, Mr. Bareford stated to the Board at that time with reference to this second amendment to the basic agreement?

A. Under the basic agreement, three pictures had been produced, and there were three more to be produced. This provided for an extension—I don't recall what the extended time was—an extension on producing those three pictures, and it also provided for making three additional pictures.

Q. The original contract, as you say, called for six pictures? A. Yes.

Q. The first amendment called for four additional pictures? A. Four additional.

Q. Did this amendment provide for three additional pictures in addition to the four?

A. Yes.

Q. Making altogether 13 pictures?

(Deposition of Samuel Carlisle.)

A. 13 pictures.

Q. Did Mr. Bareford state that to the directors?

A. Yes, he did.

Q. What did he state with reference to the conditions under which the other three pictures were meant to be produced?

A. I don't just recall now what he said. I believe those three pictures there were to be on the same basis as the others, as in the four pictures.

Q. I show you a copy of the minutes of the special meeting of Warner Bros. Pictures, Inc., held on the 17th of August, 1950, and ask you to examine so much of it as is necessary to refresh your mind, and particularly the last page which [597] refers to this matter.

A. Yes, all to be produced prior to January 1, 1953.

Q. By refreshing your recollection, you now remember more of the details of that matter as it was brought before the Board of Directors?

A. Yes.

Q. Have you examined the minutes?

A. Yes."

May I pause at this point, your Honor, to say that the minutes of the meeting of August 17, 1950 are in evidence in this case as Exhibit No. 23?

The Court: So stipulated?

Mr. Williams: So stipulated, your Honor.

Mr. Levy: "Q. Have you examined the minutes?

A. Yes.

(Deposition of Samuel Carlisle.)

Q. Did they appear to be correct minutes of that meeting as you recollect it? A. Yes.

Q. In so far as it refers to this matter?

A. Yes, that's right. [598]

Mr. Williams: May we have this copy of those minutes attached to the deposition, marked as Defendants' Exhibit No. 1 for identification in connection with the deposition?

Mr. Pottish: No objection.

Mr. Williams: And the only portion of the minutes which I am really interested in is the portion showing who was present and the portion of the last page of the minutes which shows the action with reference to the United States Pictures-Warners contract."

The reporter's note proceeds, in parentheses, as follows:

> "Copy of minutes of meeting of Board of Directors of Warner Bros. Pictures, Inc., held on the 17th of August, 1950, was marked Defendants' Exhibit 1 for identification.)"

Mr. Williams proceeds as follows:

"Q. (By Mr. Williams): Mr. Carlisle, was a vote taken on this matter? A. Yes.

Q. Did the directors vote to approve the contract? A. They did. [599]

Q. You, yourself, I take it, voted in the affirmative? A. Yes, I did.

Q. Did any person, either before or during that meeting, at that time say to you in what way you should vote on that matter? A. No.

(Deposition of Samuel Carlisle.)

Q. When you voted, did you do so in the exercise of your independent judgment as to how the matter should be voted?

A. Yes, I did.

Q. Mr. Carlisle, in the number of years that you have been a director of Warner Brothers, has either Albert or Harry or Jack Warner, or any other person purporting to speak for them, directed you as to how you should vote on any matter which came before you as a member of the Board of Directors?

A. No, no one has either directed me or even suggested to me.

Q. That includes all of these matters involved in the United States Pictures deal?

A. Yes, it does. * * * * * [600]

Cross Examination

Q. (By Mr. Pottish): Referring to that meeting of September 25, 1945, you told us that Major Warner announced the resignation of Mr. Bernhard. A. Yes.

Q. Was it also Major Warner at that meeting who stated the reasons to the meeting for Mr. Bernhard's resignation, and stated the background of Mr. Sperling? [601] A. Yes.

Q. Did you have any independent knowledge, besides Major Warner's statement of Mr. Bernhard's reasons for his resignation?

A. No, that's all. * * * * * [602]

Q. In any event, did you cause any independent

(Deposition of Samuel Carlisle.)

investigation to be made concerning Mr. Sperling's background or experience prior to that meeting of September 25th?

A. No. As I say, we rely on the judgment of the executives in charge of that particular end of the business.

Q. Yes, you stated that, and when you say you relied on the executives in charge of that branch, to whom specifically do you refer?

A. Jack Warner is in charge of production, and H. M. Warner is in charge of everything—he is the President of the company.

Q. Of what?

A. Of everything; he is President of the company.

Q. So you relied principally on the recommendations of Jack and H. M. Warner in these connections concerning Mr. Sperling?

A. And what I had seen in trade papers occasionally. * * * * * [603]

Q. Did Major Warner, in announcing these facts on that meeting of September 25th, state that he thought Mr. Bernhard going with Mr. Sperling would be a good combination?

A. That is my recollection. * * * * *

Q. Did Major Warner say that the Bernhard-Sperling combination would be of any benefit to Warner Brothers?

A. He might have said so as an independent producer, producing pictures for Warner Brothers.

Q. Was it stated at that meeting of September

(Deposition of Samuel Carlisle.)

25th that the combination of Sperling and Bernhard would become independent producers of pictures for Warner Brothers?

A. At the meeting of the 25th?

Q. Yes. [604]

A. Well, I believe it was stated that that was what they had in mind.

Q. And this was all stated by Major Warner?

A. Yes.

Q. Well, coming forward to the meeting of September 28, 1945, in which you say the contract between United States Pictures and Warner Brothers was approved—— A. Yes.

Q. I believe you testified that Major Warner gave some explanation of the deal, and then Mr. Friedman gave the balance of the explanation of the deal. A. Yes.

Q. Prior to that meeting had you seen a draft of the contract which was being approved?

A. No, I don't think I had, sir.

Q. And did you in a great measure rely upon the recommendations of Major Warner and Mr. Friedman in connection with the vote at that meeting on that contract.

A. We accepted their explanation of the contract. * * * * * [605]

Q. Do you recall whether at that meeting the contract itself was passed around to all directors present for examination?

A. I am pretty certain it was not.

(Deposition of Samuel Carlisle.)

Q. Was it mentioned at that meeting that Milton Sperling was the son-in-law of Mr. Warner?

A. Yes. While I said that I am pretty certain the contract was not passed around, the contract was always on the table available for anyone who wished to look at it. That is the usual procedure.

Q. You say the explanation of the contract at the meeting was provided by both Major Warner and Mr. Friedman?

A. The Major just told in very general terms what the deal was there and turned it over to Stanleigh Friedman to explain the contract.

Q. And did you rely in a great measure on the explanation, on the introductory statement made by Major Warner and the subsequent more detailed explanation given by Mr. Friedman?

A. Yes. * * * * * [610]

Q. Do you recall who made the recommendation at the meeting of September 25, 1945, regarding Bernhard's resignation and his going into business with Sperling?

A. That would be Major Warner.

Q. Was it also Major Warner that made the recommendation at the meeting of September 28, 1945, regarding the approval of the contract with U.S. Pictures? A. Yes.

Q. Am I correct in assuming that Major Warner is Mr. Albert Warner?

A. Albert Warner, Vice-President and Treasurer.

Q. Let us go on to the contract of December 6,

(Deposition of Samuel Carlisle.)

1947. Do I understand correctly that there was no meeting of the Board of Directors to approve or disapprove this contract?

A. Apparently it was not approved.

Q. It was simply made by the officers of the company? A. Yes.

Q. And you thereafter saw a copy of that contract?

A. Yes, I received it in the same month in which the contract was drawn. [617]

Q. You received it the latter part of December, as I recall your testimony.

A. The 26th of December, to be exact.

Q. You had no say in whether or not that contract should or should not have been made prior to its execution? A. No.

Q. Coming down to the directors' meeting of August 17, 1950, at which you testified the directors passed on a further amendment to the basic agreement. Do you have any independent recollection or any notes which indicate to you whether or not you saw a copy of that proposed amendment prior to that directors' meeting?

A. I have no notes, but I had heard it in discussion amongst ourselves. [618]

Q. At the meeting, who presented that amendment? I withdraw that.

I have here a record that Mr. Bareford——.

A. Mr. Bareford explained it.

Q. Explained the amendment at the meeting?

A. Yes.

(Deposition of Samuel Carlisle.)

Q. Did he make a recommendation with regard to it? A. No, I don't think so.

Q. Was there any executive of the company that made a recommendation regarding that amendment at that meeting?

A. I would assume that Major Warner recommended it as being the opinion of the studio executives.

Q. He is in charge of that phase of it, Major Warner?

A. No, he is the Treasurer. Jack Warner is in charge of the studio, but he is very seldom at our meetings.

Q. Did you rely to some measure upon the recommendations of Major Warner and upon the explanation of the amendment as made by Mr. Bareford before arriving at your vote?

A. Yes. Major Warner generally passes [619] along to us the opinions of his brothers as to the collective opinion.

Q. He represents his brothers at the meetings?

A. Yes.

Q. In that way, all the brothers do not have to be present at the meetings?

A. Well, it isn't for that reason they stay away. They are out on the Coast.

Q. Well, these meetings were held in New York?

A. They were held in New York.

Q. And Major Warner was the Warner brother that was here at those meetings?

A. His headquarters are in this office.

(Deposition of Samuel Carlisle.)

Q. When he makes these recommendations, he makes it understood that he is speaking for the three Warner brothers?

A. Well, we all accept it that way.

Q. Did you, prior to approving the amendment agreement of August 17th that was presented at the meeting of August 17, 1950, investigate whether at that time the distribution percentage to the Warner Bros., distribution Company was a fair one?

A. Yes. I didn't investigate; just from general knowledge. [620]

Q. Are you familiar with the records of the distribution company? Does that come within your jurisdiction as Controller? A. Yes.

Q. Do you know whether they were making a profit under that distribution fee of 20 per cent?

A. It is very hard to say whether you are making a profit on an individual picture. We have our branches all throughout the country, and the overhead runs on whether you have 15 pictures or 20 pictures; so that the more pictures you have, the lower the overhead is on all of them.

Q. Well, did you have prepared for yourself any analysis which would allocate to these pictures being produced by United States Pictures a percentage of the total overhead of the distribution corporation so that you could figure out whether the distribution corporation was making a profit on this distribution contract?

A. The distribution company for a number of years has made a profit on the 20 per cent that we

(Deposition of Samuel Carlisle.)

allow them for distributing Warner Brothers pictures and all other pictures.

Q. And no other pictures?

A. All other pictures.

Q. And all other pictures? [621]

A. Yes.

Q. Did you ever investigate as to whether they would, after analysis, be making a profit only with respect to the United States Pictures' pictures?

A. There was no way of finding that out.

Q. Well, isn't there a way of allocating the United States Pictures' overhead as against the rest of their overhead?

A. You can do so, but it isn't quite satisfactory. You still have that overhead running on.

Q. At whose instance were you elected a director of th company, Mr. Carlisle?

A. Mr. Warner.

Q. Which Warner?

A. H. M. Warner.

Q. I take it that as annual elections of directors take place, why, the directors are nominated by a group, a committee?

A. It is generally Mr. Warner there that is asked if he wishes to make any changes.

Q. And he, in effect, controls the naming of the Board of Directors, does he not?

A. That is, those inside the organization.

Q. Yes. And you are mindful of that?

A. Yes. [622]

Q. Mr. Warner and his two brothers in effect

(Deposition of Samuel Carlisle.)

control, do they not, whether or not you shall stay on as Controller or Assistant Treasurer of the company? A. Certainly. * * * * *

Q. Did you exercise any surveillance over the administration of the contract between Warner Brothers and United States Pictures regarding the amount of overhead charges which were being charged by United States Pictures?

A. That is done at the Coast.

Q. You exercised no surveillance on that?

A. No.

Q. You were unaware at the time you voted for the amendment in August of 1950, as to how that portion of the contract was being administered.

A. Well, I do know that they watch it closely and check up on it. [623]

Q. Yes, but you personally have no knowledge of that administration? A. No."

* * * * * [624]

Mr. Levy: I will call Mr. Roy Obringer.

ROY JOHN OBRINGER

called as a witness on behalf of the plaintiff, having been first duly sworn, testified as follows:

The Clerk: Will you state your name to the court?

The Witness: Roy John Obringer.

Direct Examination

Q. (By Mr. Levy): Mr. Obringer, are you the Obringer who signed and who verified the inter-

(Testimony of Roy John Obringer.)

rogatories addressed to Warner Bros., copies of which I will show you in evidence in this case as Exhibits 104-A and 107? A. Yes, sir.

Q. You are Assistant Secretary of Warner Bros. Pictures, Inc.? A. I am.

Q. Are you an employee of Warner Bros?

A. Yes, I am. * * * * * [626]

Q. What are you duties, generally?

A. I am the resident attorney of Warner Bros. Pictures, Inc., at its studio at Burbank, California, having administration of the contract department. * * * * * [627]

Q. (By Mr. Levy): Mr. Obringer, you were asked the following question——

Mr. Williams: What page?

Q. (By Mr. Levy): I am referring now to page 2 of Exhibit 107, subdivision "(h) State the dates and amounts of cash loans or advances (if any) made by Warner to United in connection with the production of said picture;"

And your answer was: "None; however, Warner made cash loans for general purposes as follows: September 11, 1945, $50,000; February 15, 1946, $100,000." [634]

I ask you, Mr. Obringer, what you meant by the words "general purposes" in your answer?

A. The figures which you have quoted were obtained by me from the accounting department. And, may I see the question, please?

Mr. Levy: Yes.

The Court: The clerk will place the original ex-

(Testimony of Roy John Obringer.)

hibit before the witness. What is its number, 107?

Mr. Levy: 107, your Honor.

The Court: Interrogatories, is it not?

Mr. Levy: Interrogatories, yes, your Honor.

The Witness: I am unable to answer the question. * * * * * [635]

Q. Does your answer hold good with respect to the $100,000 loan? A. It does.

* * * * * [636]

Mr. Levy: May I at this time, your Honor, read into the record the deposition of the plaintiff Edward S. Birn? It is Exhibit 22 in evidence.

The Court: You may. Exhibit 22?

* * * * * [657]

DEPOSITION OF EDWARD S. BIRN

Mr. Levy: "Deposition of Plaintiff Edward S. Birn taken at the office of Moroney, Ettinger & Pottish, 271 Madison Avenue, New York, New York, on May 21, 1951, at 10:30 a.m. pursuant to stipulation made among the attorneys for the respective parties dated May 2, 1951.

"Present: Edward S. Birn, Plaintiff. Sol Pottish, Esq., of Moroney, Ettinger & Pottish, 271 Madison Avenue, New York, attorneys of counsel for Moss, Lyon & Dunn of 210 West 7th Street, Los Angeles 14, California, attorneys for the plaintiff. Eugene D. Williams, Esq., of counsel for Freston & Files and Eugene D. Williams of 650 South Spring Street, Los Angeles, 14, California, attor-

(Deposition of Edward S. Birn.)

neys for defendants Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, Joseph D. Karp, Esq. of Friedman & Bareford of 11 West 42nd Street, New York, New York, of counsel for [658] defendants Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner. * * * * *

"The plaintiff, being first duly sworn, testified as follows:

Q. (By Mr. Pottish): Mr. Birn, at the time of the commencement of this suit in 1948, were you the owner of 400 shares of stock of Warner Bros. Pictures, Inc.? A. I was.

Q. Had you continuously been the owner of those shares of stock since August 21, 1944?

A. I have been continuously the owner of these 400 shares but I sold 200 shares about the early part [659] of May, 1951.

Q. So that at this time you are the owner of the 200 of the original 400 shares? A. Yes.

Q. Do you recall bringing a law suit in the State of California on behalf of the stockholders of Warner Bros. Pictures, Inc. against the officers and directors for a claim of wrongdoing on their part in connection with certain contracts and dealings between Warner Bros. Pictures Inc. and United States Pictures Inc.?

A. I do. I believe our suit was started in December 1948.

Q. Do you recall the transactions complained about in that law suit had their inception in a contract made between Warner Bros. Pictures Inc.

(Deposition of Edward S. Birn.)

and the United States Pictures Inc. in September 1945?

A. In 1948 I found out the facts but in 1945 I did not know them. * * * * * [660]

Q. When did you first learn of that contract or of any dealings between United States Pictures Inc. and Warner Bros. Pictures Inc.?

A. In late September or early October in 1948, I overheard a conversation in a broker's office that Warner Bros. was being sued for some very large sums of money. I injected myself in this conversation but was not able to get all the facts. I then contacted Harry Ettinger who I have known for many years and asked him whether he would investigate and see whether there was anything to it. * * * * * [661]

Q. As a result of that conference with Mr. Ettinger, did you authorize the bringing of a law suit against United States Pictures Inc. and the directors and officers of Warner Bros. Pictures?

A. I did." [662]

"Q. And subsequently after that suit was brought in New York, did you authorize an additional suit to be brought in California?

"A. Mr. Ettinger explained to me that he could not serve the directors in New York and thought it would be necessary to bring a suit in California and I authorized him to do it.

"Q. Did you from time to time receive Proxy Statements and Notices of Meetings of Warner Bros. Pictures, Inc.?

(Deposition of Edward S. Birn.)

"A. I receive Proxy Statements from Warner Bros. and many others every day.

* * * * * [663]

"By Mr. Williams: What is your full name?

"A. Edward S. Birn. * * * * *

"Q. You are in the stock market as a business?

"A. No, sir.

"Q. And your purchase of Warner Bros. stock was a private investment of your own?

"A. That is right. * * * * * [664]

"Q. How many years have you been a stockholder?

"A. I have owned Warner Bros. stock fifteen to twenty years back to 1929.

"Q. During that time every year you have received, have you not, notice of Stockholders Annual Meeting and also Proxy Statement and Financial Statement from the company?

"A. I get them every day from Warner Bros. and many other companies.

"Q. Specifically from Warner Bros., a proxy statement, a proxy, a financial statement and a notice of stockholders meeting each year you have been an owner?

"A. I guess I did.

"Q. When you say you guess you did, you would not say that you did not receive them?

"A. I am sure they didn't single me out to omit me. * * * * * [665]

"Q. Mr. Birn, I show you a proxy which appears to be addressed to Edward S. Birn, 1450 Broad-

(Deposition of Edward S. Birn.)

way, which bears date January 14, 1946, and appears to be signed Edward S. Birn. I will ask you to state whether the writing January 14th and Edward S. Birn were written by you? [667]

"A. That is my signature. * * * * *

"Q. I also have a proxy addressed to Edward S. Birn, 1450 Broadway, New York City, which appears to have been dated in ink, January 23, 1947, and was signed Edward S. Birn in ink. I ask you whether you put in the ink date January 23 and the name Edward S. Birn in that proxy.

"A. That is my signature, the same as the other.

"Q. And you undoubtedly signed that proxy to Warner Bros.?

"A. Yes, I as a rule sign the proxy and save the company the expense of sending me a duplicate or a second request. * * * * *[668]

"Q. And do you expect personally to gain anything from the case other than your participation as a stockholder in the benefits to be received by the corporation, if any?

"A. No. I own too many stocks and have been hurt too often by unethical practices of directors and officers.

"Q. Do you have any agreement with Mr. Ettinger or his firm to the effect that you will participate in any fee which may be allowed by the court in case this action may be successful?

"A. I do not.

"Q. Do you anticipate or expect to gain any

(Deposition of Edward S. Birn.)

[670] advantage of any kind whatsoever other than the advantage that any stockholder may gain from whatever judgment might be derived in this lawsuit for the benefit of the corporation?

"A. I do not. * * * * *

"By Mr. Pottish: Q. When you authorized Mr. Ettinger to bring this lawsuit, did you authorize him to take any steps necessary to prosecute this case successfully?

"A. I did.

"Q. It is my understanding, Mr. Birn, that you told me that you had agreed with Mr. Ettinger by way of a gentleman's agreement that if he were unsuccessful in this lawsuit that you will figure out some reasonable compensation for the time he spent. Did you agree to such compensation?

"A. I did.

"Q. When you answered Mr. Williams a little while ago, you stated the only fee was to reimburse him for his expenses. [671]

"A. I overlooked that. Mr. Ettinger said it would be a reasonable fee and we would sit down and discuss it.

"Q. I show you Exhibit D, being proxy dated January 14, 1946, and ask you whether if at the time that proxy was before you for signature you knew about the claimed unethical and wrongful acts which you have alleged in your complaint, whether you would have signed this proxy and ratified the acts of the directors?

"A. Certainly I would not."

* * * * * [672]

Signed "Edward S. Birn."

"Sworn to before me this 12th day of June, 1951.

"Benjamin L. Hoch, Notary Public.

* * * * * [674]

Mr. Williams: If your Honor please, may I at this time offer into evidence the various documents which have [675] been identified as attached to the depositions as Exhibits A, B, C, D, and E?

The Court: Aren't they in evidence as part of the deposition?

Mr. Williams: Yes.

Mr. Levy: They are, and if they are not, I have no objection to the offer that is made.

The Court: I just want the record to be clear. I made an announcement on the record the other day that, in the absence of any objection or any exceptions to it, whenever any writing is offered in evidence which has some attachments to it, that the attachments will be deemed in evidence with the writing and bear the same identification in the record here under a sub-numbering or sub-lettering as they bear originally in the exhibit. For instance, Exhibit A to the Birn deposition would be in effect 22-A here in the record.

Mr. Williams: As long as there is no misunderstanding on it. I just wanted to be sure that the documents were in evidence.

And may I at this time, if it is convenient, call the court's attention to the fact that the Proxy Statement which is Exhibit A attached to the depo-

sition of Edward S. Birn which has just been read, on page 3 of that Proxy Statement there is a statement with reference to this transaction which is involved in this case. Would it be of convenience [676] to the court if I read it at this time, just one paragraph dealing with this transaction?

The Court: Yes.

Mr. Williams: It is headed "Transactions Between the Corporation and Directors.

"On September 28, 1945 this Corporation entered into an agreement with United States Pictures, Inc., of which Joseph Bernhard is President and owner of 50% of the stock, for the production of six feature motion pictures for distribution by this Corporation. Warner Bros. Pictures, Inc. does not own any of the capital stock of United States Pictures, Inc. The agreement provides generally as follows. The motion pictures are to be produced at the studios of this Corporation and this Corporation agrees to advance 50% of the cost of production of each motion picture by either cash, charges for talent and facilities furnished for the production of the motion pictures, or proportional charges for overhead of studios, etc. Subsidiaries of this Corporation will distribute the pictures throughout the world and retain from the gross proceeds certain direct expenses and certain percentages of the gross receipts of distribution which vary for different countries. United States Pictures, Inc. is required to provide [677] the other 50% of the cost of production of each of the motion pictures, and may borrow this and pledge as security therefor

the negatives, positive prints and all of the net proceeds of distribution after the deductions above referred to.

"On November 2, 1945, a loan agreement was entered into between The New York Trust Company, as lender, United States Pictures, Inc., as borrower, and this Corporation, for such part of the cost of production as may be borrowed by United States Pictures, Inc., which agreement provides for the pledge of the security referred to in the preceding paragraph. After such loans shall have been repaid and Warner Bros. Pictures, Inc. has been reimbursed for the amounts advanced by it, and then United States Pictures, Inc. has been reimbursed for the balance of the amounts advanced by it, then Warner Bros. Pictures, Inc. and United States Pictures, Inc. shall share equally in the remaining net proceeds of distribution."

* * * * * [678]

(Plaintiff's Exhibits 37-A to 37-G, inclusive, for identification were received in evidence.)

Mr. Williams: If your Honor please, I may be in error, but I understood that the court was limiting the evidence at this time to the question of the applicability of the statute of limitations, and the matter that counsel just referred to obviously has nothing to do with that subject.

It doesn't make any difference to us personally whether we do or do not limit the evidence.

I just want to know where we stand on that subject.

Of course, your Honor, we anticipated and hoped for a judgment that would involve the merits of this case, but your Honor has very properly suggested that the matter might be disposed of on the applicability of the statute of limitations, and I understood at this time we were addressing ourselves to that one issue.

The Court: I want to try that issue first. The first issue in this case, as it is in every case in the Federal Court, is one of jurisdiction.

* * * * * [681]

Mr. Levy: I offer in evidence Exhibit 36-A, presently marked for identification, that being the minutes of the annual meeting of the stockholders of Warner Bros. held on the 18th day of February, 1947. Incidentally, might I ask Mr. Williams, have you the minutes for 1946? [712]

Mr. Williams: I don't think so.

Mr. Levy: This is the first set of minutes that——

The Court: Do you expect to offer all those minutes listed on page 6 of Exhibit 102?

Mr. Levy: Yes.

The Court: Then you offer Exhibit 36-A, the 1947 minutes; Exhibit 36-B, the 1948 minutes; 36-C, the minutes of the 1949 meeting; 36-D, the minutes of the 1950 meeting of stockholders; Exhibit 36-E, the minutes of the 1951 meeting; 36-F, the minutes of the 1952 meeting; and Exhibit 36-G, the minutes of the 1953 meeting of stockholders?

Mr. Levy: Yes, your Honor.

The Court: Any objection?

Mr. Williams: Yes, We object to them on the grounds they are not competent, relevant, or material, do not prove or tend to prove any issue involved in this case.

The Court: The objection is overruled. They are received in evidence.

(Plaintiff's Exhibits 36-A to 36-G for identification were thereupon received in evidence.)

* * * * * [713]

The Court: Very well. Please mark it Exhibit 120 for identification, the deposition of John Bierworth. Do you offer it in evidence?

Mr. Levy: Yes, your Honor. * * * * *

(The document was thereupon marked Plaintiff's Exhibit 120 and received in evidence.)

* * * * * [717]

DEPOSITION OF JOHN BIERWORTH

"Examination of Mr. John Bierworth as witness pursuant to stipulation between attorneys for respective parties, dated August 30, 1950, and subsequent adjournments made under said stipulation. The examination was held at the office of Mr. Bierworth, at National Distillers Corp., 120 Broadway, New York, New York, on November 3, 1950 at 2:30 p.m.

"Present: Mr. John Bierworth, Witness, Stanleigh Friedman, Esq., attorney for Mr. Bierworth, Joseph D. Karp, Esq., attorney of counsel for Warner Bros. Pictures, Inc. Sol Pottish, Esq., attorney of counsel for plaintiff.

(Deposition of John Bierworth.)

The witness, being duly sworn, testified as follows:

* * * * *

Questions by Mr. Pottish: [718]

Q. Between what dates were you director of Warner Bros. Pictures, Inc.?

A. I still am. November 23, 1945 to date.

Q. During what period were you a director of New York Trust Company.

A. September 19, 1941 to date.

Q. During what period of time were you an officer of New York Trust Company and what was that office.

A. Vice President, from October, 1929 to September, 1941; President from that date to, I think, November 9, 1949.

Q. Do you know Harry Warner, Jack Warner and Albert Warner. A. Yes.

Q. Did you know them prior to the time you became a director of Warner Bros. Pictures, Inc.

A. Yes.

Q. Have you known Milton Sperling since the date of your directorship in Warner Bros. Pictures, Inc.

A. You mean since I became a director ~~or prior~~ to that time.

Q. Was it prior to the time you became director of Warner Bros. Pictures, Inc. that you became director of Warner Bros. Pictures, Inc. that you [719] knew him. A. I think so.

Q. Do you know him to be a son-in-law of Harry Warner? A. Yes.

(Deposition of John Bierworth.)

Q. Were any or all of the three Warner brothers instrumental in effecting your election as director of Warner Bros. Pictures, Inc.

A. I don't know.

Q. Do you know who nominated you to be a director. A. I don't know.

Q. Who notified you of your election as director.

A. The Board of Directors.

Q. Prior to your notification did you not know you were being elected.

A. You don't call up someone and tell him you are a director without first someone calling you up to ask if you would serve if elected.

Q. In this case you were asked prior to your election to serve by Harry Warner.

A. That is right.

Q. Subsequent to your election as a director of Warner Bros. Pictures did you attend every meeting [720] of the directors. A. No.

Q. Do you have any recollection or record of just which meetings you did or did not attend.

A. The minutes would show that. I do not know.

Q. In what manner did you keep yourself informed of the affairs of the corporation subsequent to your election.

A. You could ask that about any company but could not answer it. You talk to the officers—you go to as many meetings as you can.

Q. Were most of your discussions concerning the company's affairs had with either or all of the three Warner brothers.

(Deposition of John Bierworth.)

A. No. I would say they were more with the treasury end of the business. Possibly with Stuart McDonald more than anyone else.

Q. Who was Stuart McDonald.

A. Assistant Treasurer.

Q. Subsequent to your election did you learn of an agreement which had been made between Warner Bros. Picture and United States Pictures dated September 28, 1945 which concerned production of motion pictures by United States Pictures, Inc. using Warner Bros. Pictures' facilities. [721]

A. I learned of it prior to my election. Whether or not I had seen the specific agreement I do not know but the loan negotiations with the New York Trust Company were based on the assumption that an agreement embodying the features as outlined would be signed between United States Pictures and Warner Bros. Pictures.

Q. When you speak of loan by New York Trust you are speaking of a loan agreement which was signed on October 31, 1945, the parties to which were New York Trust, Warner Bros. Pictures and United States Pictures.

A. I do not know the date of that agreement but I am referring to the only agreement I know of between the two.

Q. That refers to loan to be made to United States Pictures to finance their production of pictures under their agreement with Warner Bros. Pictures. A. I assume that is so.

(Deposition of John Bierworth.)

Q. Did you have any part in the negotiations leading up to that agreement. A. Yes.

Q. In what capacity did you act?

A. As President of New York Trust Company.

Q. Did you participate as President of New York Trust Company in the negotiation of the agreement made October 31, 1945 between New York Trust Company, Warner Bros. Pictures, Inc. and United States Pictures, Inc.

A. What agreement is that.

Q. Roughly, that agreement referred to a loan to be made by New York Trust to United States Pictures for the purpose of helping United States Pictures produce pictures under its agreement with Warner Bros. Pictures. A. Yes.

Q. As President of New York Trust were you in charge of all loan negotiations with moving picture companies?

A. As President of New York Trust I was in charge of everything, I presume. Not necessarily specifically. I knew of all loans made, of course.

* * * * *

Q. Did you take a personal participation in this loan agreement with United States Pictures, Inc.

A. Yes. [723]

Q. Did you investigate into the propriety of the basic agreement between Warner Bros. Pictures and United States Pictures before you approved the loan to United States Pictures.

A. I don't think I know what you mean by the propriety of it.* * * * *

(Deposition of John Bierworth.)

Mr. Levy: "Q. Did you investigate into the reasonableness of the agreement before you approved the loan to United States Pictures?

Objection by Mr. Friedman as calling for conclusion.

Mr. Karp: Same objection. (Not answered.)

* * * * * [724]

Q. Mr. Bierworth, I am not referring to the loan agreement. I am referring to the agreement between Warner Bros. Pictures and United States Pictures which had to be executed as a condition to your making the loan to United States Pictures and I ask you with respect to that agreement whether or not you investigated into its terms and knew of them fully before you approved the loan to United States Pictures.

A. I do not think I could answer that. I do not think I know.

Q. Did you actually read over the agreement between United States Pictures and Warner Bros. Pictures before approving the loan to United States Pictures.

A. I would doubt it because the usual method on a loan of this type is to turn it over to your attorney who sees if the papers are drawn in accordance with [725] the understanding

Q. In making the loan were you concerned with the relative advantages to either United States Pictures or Warner Bros. Pictures under their agreement between themselves. A. No. * * * * *

Q. Subsequent to your election as director of

(Deposition of John Bierworth.)

Warner Bros. Pictures did you exercise any surveillance over the administration of the agreement between Warner Bros. Pictures and United States Pictures. A. No.

Q. Subsequent to your election did you make a study of the terms of the agreement existing between Warner Bros. Pictures and United States Pictures and the amendments thereto.

A. No.

Q. Are you familiar with the loan agreements outstanding between Warner Bros. Pictures as a borrower [726] and a series of institutions including New York Trust Company which evidenced a loan in the original total amount of $15,000,000.

A. I was at the time, as I arranged the loans.

* * * * *

Q. Were you familiar with the provisions of the loan agreements between Warner Bros. Pictures and New York Trust Company and other banks.

Mr. Friedman: Same objection." [727]

Mr. Williams: We waive the objection.

Mr. Levy: "A. In general I was familiar but I do not remember details. They were always handled by our attorneys.

Q. Specifically do you recall whether there was any provision included in the loan agreement between New York Trust Company and Warner Bros. Pictures to the effect that without the consent of 75% of the holders of Warner Bros. Pictures' notes, Warner Bros. Pictures could not pledge any of its

(Deposition of John Bierworth.)

assets or moving pictures or moneys due under contracts."

Mr. Williams: The objections are waived, your Honor.

Mr. Levy: "Mr. Karp objected to this as improper in form and also on the grounds of being incompetent, irrelevant and immaterial.

"Mr. Friedman: I object on all the grounds interposed and on the further ground that the document speaks for itself. You asked if he was aware of it and I say the document speaks for itself.

A. I do not recall specifically. I would have to refer to the agreement. If it was in there I would have known at the time—if not I would not have known of it. * * * * * [728]

Q. In this particular case, Mr. Bierworth, tell us in your own words what considerations were given the greatest weight by you prior to your approval of the loan to United States Pictures.

Mr. Friedman objected to this question based upon the fact that it calls for mental conclusions and not statements of fact and therefore is objectionable. Same objection by Mr. Karp."

Mr. Williams: We add to it the objection that it does not prove or tend to prove any issue in this case. It does not make any difference what the reasons which actuated the officers of the New York Trust to make the loan. The question is not relevant to any issue involved here. They could have made it for any one of a thousand reasons.

Mr. Levy: Well, in answer to Mr. Williams may

(Deposition of John Bierworth.)

I say this, your Honor: That the question has this bearing upon the total issue which is, has been and will be placed before this court, namely, whether or not the Warner Bros. in this case were the control of this corporation in essence and in reality, irrespective of the forms that either the board of directors went through or any of the officers or employees went through.

The Court: Overruled. You may read the answer.

Mr. Williams: Your Honor, this man was not an officer or an employee or a director of Warner Bros. [731]

The Court: Overruled.

Mr. Levy: "A. I think they are right. I think it is impossible to recall 5 years ago what my conclusions were. I think I can tell you in general, if you want to know what anyone's reasoning is that lends money." * * * * *

Q. Did you know at that time that United States Pictures were being capitalized with a capital of $25,000.

A. If that was a fact I assume we did.

Q. You also knew at that time, did you not, that the principal officer of United States Pictures were Messrs. Milton Sperling and Joseph Bernhard.

A. Yes.

Q. Did their credit standing play any part in the question of whether the loan should be approved to United States Pictures. [732]

A. I cannot recall.

(Deposition of John Bierworth.)

Q. Is it not a fact that the New York Trust Company also considered, prior to approving the loan, the fact that the loan would be repaid out of the proceeds of the motion pictures to be produced under the agreement between United States Pictures and Warner Bros. Pictures.

A. That is right.

Q. Would you say that principal consideration was given by you to the latter fact as the basis for extending the loan to United States Pictures—the latter fact referred to being the fact that the loan would be repayable out of the proceeds of the moving pictures to be produced.

A. Yes.

Q. Would you have agreed to make a loan agreement of that size with United States Pictures in the absence of Warner Bros. Pictures being a party to the agreement. A. Yes.

Q. Do you recall who handled the negotiations for the loan agreement on behalf of United States Pictures. A. Bernhard.

Q. Do you recall who handled the negotiations [733] for that loan on behalf of Warner Bros. Pictures. A. No.

Q. That loan agreement to United States Pictures was not the only loan ever negotiated by you to a moving picture company. A. No.

Q. Has it been customary or usual in your practice as president of the bank to extend loans to a moving picture company for the entire cost of production of a movie.

(Deposition of John Bierworth.)

Mr. Friedman objected to this as irrelevant, incompetent and not within the issues of this action as set forth in the complaint and answer.

Mr. Karp objected to this as improper in form.

Mr. Friedman instructed witness not to answer." And we proceed to the next question.

"Q. During the existence of the loan agreement, did you ever familiarize yourself either as president of the New York Trust Company or as director of Warner Bros. Pictures with the salary that Sperling was receiving in his connection with United States Pictures. A. No.

Q. Did you in those capacities ever investigate [734] or attempt to determine the manner in which the contract between United States Pictures and Warner Bros. Pictures was being administered.

A. No.

Q. At any time during the existence of the loan agreement did the bank attempt to regulate the amount of salaries or overhead being incurred by United States Pictures.

A. Not to the best of my knowledge.

Q. Is United States Pictures a depositor in New York Trust Company.

A. I do not know. * * * * * [735]

"Q. The same question as to Warner Bros. Pictures.

"A. Yes. They are and were a depositor.

"Q. The same question as to any of the three Warner brothers.

"Mr. Friedman objected to this on ground ques-

(Deposition of John Bierworth.)

tion is irrelevant, immaterial, and privileged and he moves to strike out the question and instructs the witness not to answer. Mr. Karp made the same objection."

Now, may it please the court, preceding Mr. Friedman's objection, that is to say, as the deposition exhibits the fact, in between the line on which the question is written and the line on which Mr. Friedman's objection is noted as aforesaid, the witness has apparently, before he signed and swore to this deposition, made the following answer, and this is written in ink:

"A. Banks don't give out confidential information."

I proceed with the reading of the next question:

"Q. As director of Warner Bros. Pictures, did you make any investigation to satisfy yourself whether or not in your opinion the agreement between Warner Bros. Pictures and United States Pictures was fair to Warner Bros. Pictures? [736]

"A. No.

"Q. Do I understand you correctly when I say that your testimony is that the loan agreement between New York Trust Company and United States Pictures, to which Warner Bros. Pictures was a party, was based upon and would not have been executed without the execution of the corollary agreement between Warner Bros. Pictures and United States Pictures for the production of movies?

"A. I think that you will find, if you refer to

(Deposition of John Bierworth.)

another question in which you asked me if I examined the credit of United States Pictures and would have made the loan without the Warner Bros. Pictures being party to the agreement, my answer was that I would. * * * * * [737]

It is signed "John E. Bierwirth.

"Witness.

And, "Sworn to before me this 30th day of November, 1950. Andrew A. Walls, Notary Public."

* * * * * [739]

Mr. Levy: I offer in evidence, your Honor, Exhibit 31 for identification, that being an agreement dated [761] August 31, 1945, between Joseph Bernhard and Milton Sperling. * * * * *

Mr. Levy: Yes, your Honor, a stockholders agreement between Bernhard and Sperling dated August 31, 1945. I offer that in evidence.

The Court: Any objection?

* * * * * [762]

Mr. Williams: It is objected to on behalf of the Warner defendants on the ground there is no foundation laid as to them. It has not been shown that it was called to their attention or that they were parties to the agreement or knew the contents thereof, and it is hearsay for that reason. * * * * *

The Court: The objection is overruled.

Exhibit 31 is received in evidence.

* * * * * [763]

DEPOSITION OF W. STEWART McDONALD

Plaintiff's Exhibit 114: Deposition of W. Stewart McDonald, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th Street, New York, N.Y. on the 18th day of May, 1951, at 11:30 a.m., before Arnold Schubert, a Notary Public of the State of New York. * * * * * [784]

W. Stewart McDonald, called as a witness in behalf of the defendants, being first duly sworn, testified as follows: * * * * *

Direct Examination

Q. (By Mr. Williams): Mr. McDonald, what is your place of residence? [784-1]

A. Scarsdale, New York.

Q. What is your occupation?

A. I am Assistant Treasurer of Warner Bros. Pictures, Inc. I am a Vice-President of various theatre subsidiaries, a director of most of such theatre subsidiaries, and also an Assistant Treasurer of the theatre subsidiaries.

Q. You have been employed by Warner Brothers or one of the subsidiaries, one or more of the subsidiaries, for what length of time?

A. Since January 1, 1931.

Q. Prior to that time did you have any connection with Warner Brothers?

A. Yes, I did. I was with Goldman, Sachs & Company, and ever since December 1927, I have followed the affairs of Warner Brothers.

(Deposition of W. Stewart McDonald.)

From December, 1927, until the time I joined Warner, I was one of Goldman, Sachs & Company's representatives who frequently visited this office.

Q. Since you joined Warner Brothers have you made it a practice to attend the meetings of the Board of Directors of Warner Brothers?

A. I have. I did so before I joined Warner, also.

Q. You did that from the time in 1927 that you had the connection with Goldman, Sachs that you have referred [784-2] to? A. Yes, sir.

Q. You are not and never have been a director of Warner Bros. Pictures, Inc.?

A. That is correct.

Q. But you have made it a practice since 1927 to attend the meetings of the Board of Directors of that company?

A. Either late '27 or early '28.

Q. I will ask you whether you are the W. S. McDonald who is referred to in the minutes as being present at a number of the meetings?

A. I am.

Q. Mr. McDonald, do you have in mind the meeting of the 25th of September, 1945, at which there was presented to the Board the resignation of Joseph Bernhard? A. I do.

Q. You were present at that meeting?

A. I was.

Q. Can you state whether there was any statement made in connection with the presentation of his resignation as to why he was resigning from

(Deposition of W. Stewart McDonald.)

the positions of Vice-President and director of Warner Brothers?

A. Well, to the best of my recollection, and I am sure this was done, the Board was informed that Mr. Bernhard [784-3] was resigning in order to become affiliated with the new corporation, United States Pictures Company, or whatever the correct title of that company is.

Q. Was anything said as to what, if anything, United States Pictures was to do?

A. Yes. That corporation was being organized for the purpose of producing pictures which were to be distributed by the subsidiary of Warner Bros. Pictures, Inc.

Q. Was anything said at that time with reference to who else would be associated with United States Pictures?

A. Yes, Milton Sperling.

Q. Did you know at that time who Milton Sperling was? A. I did.

Q. Who was he?

A. Milton Sperling had been formerly affiliated with Fox Film and with other corporations. He was active in the production, writing and producing of motion pictures. He was the son-in-law of Harry M. Warner, President of Warner Bros. Pictures.

Q. Were all of these facts discussed at the directors' meeting at that time? A. Yes.

Q. You remember, do you, that that resignation of Mr. Bernhard was accepted at the meeting?

(Deposition of W. Stewart McDonald.)

A. That is right. [784-4]

Q. Was there any direction given by Albert Warner or anybody else, to any of the directors, as to how he should vote on that matter?

A. Well, that meeting, I believe, was merely to accept the resignation.

Q. Well, was there any direction given by Albert Warner or any other person as to how any individual director should or should not vote on that proposition? A. No direction.

Q. I now call your attention to a meeting of directors that was held on the 28th of September, 1945, at which it appears that you were also present, and I identify that meeting as being a meeting at which there was presented for action by the Board a contract between United States Pictures Corporation and Warner Bros. Pictures, Inc., in reference to the production and distribution of motion pictures. Do you remember that?

A. I do.

Q. Can you state who presented that contract to the Board?

A. I believe that Major Warner, as presiding officer, first referred to it and then it was discussed or presented more fully by Stanleigh Friedman.

Q. Do you remember whether at that time Stanleigh Friedman made statements which purported to be a recital [784-5] of the terms and conditions of the contract?

A. Yes, and I believe he had with him either a draft of the contract—I do not know if it was

(Deposition of W. Stewart McDonald.)

then in final form, but he at least had full details pertaining to such contract.

Q. Was there any discussion among those present as to the contract, its terms and advisability of having Warner Brothers enter into the contract?

A. Oh, yes. There was full discussion as to the terms and conditions of the contract.

Q. At that time was any director instructed as to how he should or should not vote on the matter?

A. No, sir.

Q. Did the directors vote unanimously to accept that contract?

A. It is my recollection they did.

Q. Do you remember now what the terms of that contract were?

A. Yes. Let me state this, that I have never read the contract or had occasion to read it. The contract related to six pictures to be produced by United States—what is it, Film Corporation?

Q. United States Pictures, Inc.

A. United States Pictures, Inc., to be distributed by the subsidiary of Warner Bros. Pictures, Inc., Warner [784-6] Bros. Distributing Corporation. Warner was to furnish 50 per cent of the financing. The subsidiary was to receive certain percentages for the distribution of the picture, certain charges were to be made in connection with such distribution, such as print costs, advertising, et cetera, and Warner was to share in 50 per cent of the profits of such pictures.

(Deposition of W. Stewart McDonald.)

Q. Those are the terms as you understood them, as stated at the meeting? A. That's right.

Q. Prior to the meeting of the 28th, the meetings of the 25th and the 28th of September, 1945, had you had any knowledge of the fact that such a contract as you have just described was in contemplation by Warner Brothers?

A. Yes, I did.

Q. Had you been out on the Coast immediately prior to that time?

A. I had. I left for the Coast the last part of August and returned around the middle of September.

Q. While you were at the Coast, had you had any conversation with any of the executives of Warner Brothers concerning this contract?

A. I did. I talked at that time to both Harry Warner, President, and Mr. Joseph Bernhard, who was still Vice-President of the corporation, during part of that time. [784-7]

Q. What was the substance of the conversation between yourself and Harry Warner at that time?

A. Harry Warner told me that he was negotiating with Milton Sperling to have him join our organization. He referred to the fact, which I had also known indirectly through other sources, that Milton had been a very successful producer and executive assistant at the 20th Century-Fox organization; that Zanuck, who was the head of production of Fox, wanted Milton to go back to Fox, but that Harry Warner was very desirous of having

(Deposition of W. Stewart McDonald.)

him join the Warner organization and that he was negotiating on behalf of the corporation whereby Milton would become affiliated with Warner Bros. Pictures.

He said that the only way in which he could arrange it would be a basis whereunder Milton would have a financial interest in the pictures produced, which would be done through the formation of a company to be owned partly by Milton. He said that there were several reasons why he was desirous of having him come in. First, his proven ability as a producer of pictures, and secondly the fact that he said he wanted to build up the manpower of the Warner organization.

He pointed out the fact that in case something might happen to Jack Warner that it was essential to have someone to back him up, in a secondary position, and he [784-8] was very desirous to strengthen our position in the producing organization by having Milton come in with the hope that he would develop so that he could take over Jack's position should something unfortunate happen to Jack.

He also told me this, which came up in the conversation with Joe Bernhard as well, that he was very desirous of having Mr. Bernhard become affiliated with United States Pictures, the reason being that Joe had proven business experience, he was a good executive, and that he thought it was very much to the benefit of the company if we could make a deal with the proposed new United States

(Deposition of W. Stewart McDonald.)

Pictures Corporation, which would have as its controlling stockholders, or most likely the sole stockholders, Milton Sperling, an experienced producer, and Joe Bernhard, an experienced business executive.

Q. This occurred while you were on the Coast and prior to the meetings of the 25th and 28th of September? A. Yes, sir.

Q. I call your attention to the fact that on the 23rd of November, 1925, there was a directors' meeting at which there was presented a short amendment to the contract with United States Pictures relating to the withholding of moneys from the United States Pictures for the purpose of reimbursing or paying loans which might be made by that company in connection with pictures. [784-9]

A. That's right.

Q. You remember the details of that matter?

A. Well——

Q. I mean, you remember that it was brought before the Board?

A. I remember that they wanted some amendment to the contract which would aid them in securing the loan from the New York Trust Company.

Q. And that had to do with the Warner Brothers paying the moneys directly to the New York Trust Company instead of——

A. To United States Pictures.

Q. That matter was explained at the Board meeting? A. It was.

(Deposition of W. Stewart McDonald.)

A. It was.

Q. And thereafter the Board approved?

A. Right.

Q. On the 18th of June, 1946, there was a meeting at which it appears that you were present and which involved the matter of an organization known as. Hemisphere Pictures, United States Pictures and Hemisphere Pictures involved Niven Busch, the author of a motion picture called Pursued, and Theresa Wright, a screen star. Do you remember that matter having been brought before the Board? A. I do.

Q. Do you recall in general the action that was [784-10] sought from the Board with reference to that picture, Pursued?

A. Yes. I know there was a great deal of discussion to determine if it was to the financial advantage of the company to enter into this modification, for, if I recall correctly, United States Pictures, in making this deal, had to give a percentage of the profit of the picture to Teresa Wright and to the other members of her company, and in giving that percentage therefor in the stars contract and for the rights to the picture, it necessarily meant that the percentage of profits for Warner would be reduced.

It was pointed out, and figures were presented, to show that it was likely to the financial advantage of the company to enter into this modification, in view of the increased percentage terms which the company would receive as a distribution fee.

(Deposition of W. Stewart McDonald.)

Q. That matter was fully discussed by those present at the Board meeting, was it?

A. It was.

Q. And was it passed by the Board?

A. It was.

Q. Now, I call your attention to a contract which was dated December 6, 1947, and which, according to our records, was not at that time presented to the Board but which had to do with the making of four additional pictures, [784-11] which were called additional pictures in the contract, and which changed the terms of the contract with reference to those additional pictures so that Warner Brothers would pay the entire cost of production, the distribution charges would be raised from 20 to 25 per cent for domestic and also raised in England and throughout the other foreign distribution, and Warner Brothers should receive 80 per cent of the profit instead of 20 per cent. Do you remember the existence of that contract, to your knowledge on or about or shortly after December 6, 1947?

A. I remember that it was discussed with me before, while it was in negotiation. I cannot tell you what date it was. If the contract is dated December, 1947, I am sure that it was prior to that time.

Q. To your knowledge, with whom was it discussed and by whom was it discussed?

A. Well, I know that Mr. Schneider and Mr. Bareford worked on the contract. I think Mr.

(Deposition of W. Stewart McDonald.)

Friedman also worked on the contract. I may have discussed it also with Mr. Carlisle.

Q. You discussed it with those gentlemen, did you?

A. Yes. I had nothing to do with the negotiation of the contract, I mean the discussions were of a general nature. But I knew of it.

Q. Do you remember that later in July of 1950 there was a second amendatory contract providing for three [784-12] additional pictures to be made, that is, three in addition to the four provided for by the December 6, 1947, contract?

A. Yes, I recall that.

Q. Was that matter discussed in your presence and by you and by others with you prior to the time that it was presented to the Board of Directors? A. It was.

Q. Were you present at the meeting held on the 17th of August, 1950, at which time the amendment of December 6, 1947, and the proposed new contract of July 21, 1950, was presented to the Board and discussed and passed on by the Board?

A. I was at the meeting; I recall that.

Q. Do you remember whether at that time the matter was discussed by the Board and in the presence of the Board? A. It was.

Q. That action was approved by the Board, was it? A. It was.

Q. Was there any disagreement among the Board as to the advisability of approving that contract? A. There was not.

(Deposition of W. Stewart McDonald.)

Q. May I ask you, was there at any of these meetings any directions or instructions from Albert Warner or any other person to any member of the Board of Directors as to [784-13] how they should vote on any of the matters submitted to them?

A. No, sir. [784-14]

* * * * *

DEPOSITION OF ALBERT WARNER

Plaintiff's Exhibit No. 115: Deposition of Albert Warner, a witness called by and in behalf of the defendants, taken pursuant to Stipulation dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 18th day of May, 1951, at 10:30 a.m., before Arnold Schubert, a Notary Public of the State of New York. [784-25]

* * * * *

ALBERT WARNER

called as a witness by and in behalf of the defendants, being first duly sworn by Arnold Schubert, a Notary Public, of the State of New York, testified as follows:

Direct Examination

Q. (By Mr. Williams): Your name is——.

A. Albert Warner.

Q. Where do you live, Mr. Warner?

A. New York City.

Q. Are you connected with Warner Bros. Pictures, Inc.? [784-26]

A. I am, yes.

(Deposition of Albert Warner.)

Q. In what capacity?

A. Vice-President and Treasurer, director.

Q. How long have you been connected with that organization?

A. Since the inception of the corporation.

Q. Prior to that time you and your brothers, Harry and Jack, were in the motion picture business in partnership, were you not?

A. Yes.

Q. You have been in the motion picture business for how many years?

A. More than 45 years.

Q. You make your headquarters at the New York offices of Warner Brothers?

A. Correct.

Q. What are your specific duties in the company?

A. No specific duties; general overall executive, confining most of my activities to the New York end of it.

Q. Your brothers regularly make their headquarters at the studio in Burbank, California?

A. They do.

Q. And in the division of work, they look after the executive problems that arise on the Pacific Coast, and you take care of them here in New York? [784-27]

A. That is correct.

Q. You customarily attend the meetings of the Board of Directors of the company, do you not?

A. I do.

(Deposition of Albert Warner.)

Q. In cases when your brother Harry is not present, you customarily preside?

A. I do.

Q. Do you have in mind a meeting of the Board of Directors of the company which was held on the 25th of September, 1945, and which I will identify as being the meeting at which there was presented the resignation as an officer and director of Joe Bernhard?

A. Yes, I recall that meeting.

Q. Do you remember whether, at the time of the presentation of his resignation, there was any statement made by you or any other person present as to the reason why he was resigning from Warner Bros.?

A. Yes, to the best of my memory he was to join Milton Sperling in the United States Pictures.

Q. Were there any statements made as to what the United States Pictures would do, what business they would engage in?

A. The production of pictures.

Q. Was anything said with reference to whether Warner Bros. would have any connection with United States [784-28] Pictures or any contractual relations with them?

A. Yes, as distributors.

Q. Was that matter discussed among the directors at the meeting at which Bernhard's resignation was presented?

(Deposition of Albert Warner.)

A. Not in general. Some of the directors knew of it. I don't recall whether it was particularly taken up.

Q. Was Mr. Bernhard's resignation accepted at that meeting? A. It was.

Q. Now, three days later, on the 28th of September, 1945, there was a meeting held at which, among other things, there was presented to the directors a proposed contract between Warner Bros. and United States Pictures, Inc., providing for the production and distribution of motion pictures to be made by United States Pictures.

A. There was.

Q. You remember that? A. Yes.

Q. Did you present that contract to the Board?

A. I did.

Q. At the time you presented it to the Board, what if any statements did you make about the contract?

A. I told the directors that it was most advantageous for our company to secure the services of Milton Sperling, who was the producer in charge of the United States [784-29] Pictures. We planned on having a good piece of manpower at the studio so that in case anything happened to Jack Warner, my brother, that we would have somebody ready there to take over and carry on. That thought was in addition to the advantageous advantages of very good pictures that would lend a great deal

(Deposition of Albert Warner.)

of earnings to our theatres and to our overall distribution end of it.

Q. Was there anything said by you or anybody else on the subject of Milton Sperling being the son-in-law of Harry Warner?

A. They all knew that, I imagine.

Q. Was there any discussion at that time about the experience that Milton Sperling had had in producing motion pictures?

A. I explained to them the background he had had as a producer and the successful pictures that he had made.

Q. Do you remember now what pictures he had made?

A. Oh, it is very difficult to remember. One I remember is something about Tripoli, Sands of Tripoli——

Q. Shores of Tripoli?

A. Shores of Tripoli, or something like that, and his general professional experience with the Fox organization.

Q. Where the terms of the contract itself explained to the Board by any person there?

A. Mr. Friedman had a copy of the contract there. He [784-30] also had a resumé, a condensed resumé of the contents of the contract. That was thoroughly explained to the directors. There were copies there available for the directors to take and read. Whether they did or not, I don't recall.

Q. Well, after the statements that you had made and Mr. Friedman's discussion of the terms of

(Deposition of Albert Warner.)

the contract, was the contract approved by the directors? A. It was.

Q. Was there any dissent from that approval?

A. No.

Q. Did you, in connection with that contract or in connection with the prior resignation of Mr. Bernhard, direct or instruct any of the directors to vote in any particular way on either of those subjects? A. We never do that.

Q. You did not in this case? A. No, sir.

Q. Did you make any statement with reference to whether you and your brothers were favorable to the contract?

A. We were favorable to the contract.

Q. Did you make a statement to that effect to the directors? A. I must have. [784-31]

Q. I now direct your attention to the fact that a meeting of the directors was held on the 23rd of November, 1945—of course, you won't remember the date, but I am just calling your attention to the fact that there was a meeting held on that date, and on that date there was a short amendment of one paragraph of the agreement between United States Pictures and Warner Brothers presented to the Board for approval, and that particular amendment had to do with the fact that, there being bank loans by United States Pictures, it provided that Warner Brothers, out of the moneys coming in from the distribution of the pictures, should withhold certain sums that would otherwise be due to the United States Pictures and pay the bank

(Deposition of Albert Warner.)

loans with them. Do you remember the circumstances of that meeting?

A. Are you referring to the Teresa Wright-Busch——

Q. No, I am referring to just a little amendment clarifying the fact that Warner Brothers, from the money received from the distribution of the pictures, should first pay the bank loans that United States Pictures had made.

A. I don't recall the specific wording of that, but the minutes show that such a meeting took place.

Q. You were present at that meeting and voted in favor of it, although you do not now remember the details?

A. To the best of my knowledge, I was present.

Q. Now, on the 18th of June, 1946, there was presented [784-32] to the Board of Directors at a meeting a proposed amendment to the contract with reference to the picture Pursued, which was a picture written by Niven Busch and in which Teresa Wright was to appear, and they had a corporation known as Hemisphere Pictures.

A. Yes, I recall that.

Q. You remember that? A. I do.

Q. What, in effect, in substance, was that deal?

A. We were anxious that the United Pictures secure Teresa Wright in the Niven Busch *Prusit* Story. We saw the possibilities of a box office attraction of that kind, and our judgment was correct; it proved very successful.

(Deposition of Albert Warner.)

In order to make that possible, on account of the setup of the Fidelity Company and the setup of the United States Pictures, we had to make some modifications to permit such a deal to be acquired, and the net results of the change in the figures and percentages whatever they were, came out just the same as if no changes were made. It was a move made necessary to secure the services of Teresa Wright and Busch in the picture Pursued.

Q. You personally were favorable to that amendment? A. Very much so.

Q. Did you state the problem to the Board before they passed on it? [784-33] A. Surely.

Q. Do you remember that that involved that Warner Bros. should receive one-third of the total profit instead of one-half, but that on the other hand the distribution percentage was increased with reference to that picture from 20 per cent to 25 per cent, and also the overhead to be charged by Warner Bros. for the use of its facilities was increased?

A. What ever the specific figures were, in the end they all came out the same as if those changes were not made. The distribution advance from 20 to 25 per cent was one item.

Q. Now, in connection with the voting on that amendment, did you dictate or direct any director how he should vote on the matter?

A. We never do those things.

Q. Well, without my asking you again, it is a

(Deposition of Albert Warner.)

fact, is it not, that in reference to every time when this United States Pictures contract was presented to the Board in any form, that there was never any direction by you given to any member of the Board as to how he should vote on the matter?

A. No. As I said, we recommend such propositions.

Q. But not directed?

A. Never directed. [784-34]

Q. I now call your attention to the fact that on the 6th day of December, 1947, there was an agreement made between Warner Bros. Pictures and United States Pictures, Inc., which provided for an amendment to the basic agreement under the terms of which United States Pictures were to make four additional pictures, and the conditions of making of those pictures were changed in several particulars: First, instead of putting up 50 per cent of the cost of production, Warners were to put up 100 per cent of the cost of production; second, instead of a distribution fee of 20 per cent domestic and 25 per cent British, and varying percentages for other foreign distribution, the distribution fee was to be 25 per cent domestic, 30 per cent British, and 30 per cent for the other foreign distribution; in the third place, the profits from the production of the pictures were to be divided, 80 per cent to Warner Bros. and 20 per cent to United States Pictures, instead of 50 per cent to each, as under the original agreement.

(Deposition of Albert Warner.)

Do you remember the circumstances of such a contract having been made?

A. Yes, I do.

Q. And do you remember that that contract was made in December of 1947, and are you aware of the fact that thereafter certain pictures were made pursuant to that amended contract? [784-35]

A. Yes, I do.

Q. Now, it just happens, Mr. Warner, that that contract was not presented to the Board of Directors for consideration at that time, but on the 21st of July, 1950, some little time later, there was a second amendment providing for three additional pictures, three more additional pictures on substantially the same terms as the pictures provided for under the agreement of December 6th and extending the time within which all of the pictures under all of the contracts should be made. Do you remember the circumstances of that agreement being made? A. I do in a way, yes.

Q. That agreement was presented to the Board of Directors at a meeting held on the 17th of August, 1950, and there was a great deal of business done at that meeting, but in particular I direct your attention to the last page, where the words beginning "The Chairman" in the paragraph that starts near the top, on down to the end of that page, recites the facts with reference to this matter. I ask you to read it.

A. (Reading): "The Chairman stated——"

Q. Well, read it to yourself.

(Deposition of Albert Warner.)

A. Oh, pardon me. (Perusing minutes.)

Q. Have you completed reading that, Major?

A. I want to read it over again. (Perusing document [784-36] again.)

Q. Major, you have read the portion of the minutes of the directors' meeting of August 17, 1950, referring to the second amendatory agreement between United States Pictures and Warner Bros. Does that refresh your recollection as to that matter having been brought before the Board of Directors? A. It was, yes.

Q. And did you present it to the Board?

A. I did.

Q. Did the Board pass favorably upon it?

A. They did.

Q. In your judgment at that time, was that good business for Warner Bros.?

A. It sure was.

Q. In your opinion, was this entire United States Pictures contract, including all of the amendments that were made, for the benefit of Warner Brothers? A. Substantially profitable.

* * * * * [784-37]

DEPOSITION OF WADDILL CATCHINGS

Plaintiff's Exhibit No. 116: Deposition of Waddill Catchings, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th Street, New York, N.Y. on the 17th day of May, 1951, before Arnold Schubert, a Notary Public of the State of New York. * * * * * [784-65]

Direct Examination

Q. (By Mr. Williams): Mr. Catchings, you are a director of Warner Bros. Pictures, Inc.?

A. Yes.

Q. And have been for how long a period of time? A. Nearly 30 years. [784-66]

Q. I want to review very briefly your business experience. What is your profession?

A. Well, I am a member of the Bar, but I haven't practiced since 1909.

Q. Have you graduated from——

A. Harvard Law School.

Q. Harvard Law School? A. Yes.

Q. After leaving Harvard, did you engage in practice here in New York?

A. Yes. I was with Sullivan & Cromwell from 1904 until 1909.

Q. In 1909, into what business did you go?

A. Well, it really was—I was really out of the law before I left Sullivan & Cromwell. My purpose in going into Sullivan & Cromwell was to engage in business law, business activities, and in 1907 I

(Deposition of Waddill Catchings.)

was sent by the firm to assist the receivers of Milliken Brothers and made my office with them, and that was from 1907 on; and in 1909 I left Sullivan & Cromwell and became an employee of the receivers of Milliken Brothers, and after that receivership ended I was appointed receiver of the Central Foundry Company—that was about 1910, I should think—and when that company was reorganized I became president of it, and continued as president of it [784-67] for a period of about ten years.

I also was president, beginning at about 1912, of the Platt Iron Works Company, in Dayton, Ohio, and continued as president of that until the company was liquidated about ten years later.

In 1915 I became associated with E. R. Stettinius in the Export Department of J. P. Morgan & Company, which was the division of J. P. Morgan & Company that did the buying for France and England before the United States entered World War I. I continued there until April, 1917, just before we entered the war, and in 1917 I became president of the Sloss-Sheffield Steel & Iron Company, of Birmingham, Alabama, and then in 1918, the first of January, 1918, I became a partner in Goldman, Sachs & Company, the banking firm, and I continued as a partner in Goldman, Sachs & Company until 1930.

Q. In addition to the corporations you have mentioned, you have also been a director and officer or otherwise connected with a great many other corporations, have you not?

(Deposition of Waddill Catchings.)

A. Yes, sir. It was the practice of Goldman, Sachs & Company, to have a partner on the Boards of Directors of companies for which they issued securities, and I was the senior partner in Goldman, Sachs & Company most of the time and I was on a great many Boards of Directors, such [784-68] as Sears, Roebuck, Underwood Typewriter Company, Cluett, Peabody Company, and at least 15 or 20 others.

Q. Among others, you have been and are now a director of Chrysler Corporation, are you not?

A. I have been a director of the Chrysler Corporation since 1929.

Q. How did you come to become a director of Warner Brothers?

A. Well, Goldman, Sachs & Company issued stock for Warner Brothers, and I went on the Board, as was the practice, to represent the public stockholders on the Board of Warner Brothers at the time the stock was issued.

Q. You went on the Board about 30 years ago?

A. Yes. I think it was about 1924, not quite 30 years ago.

Q. And you have been on the Board ever since?

A. I have, yes.

Q. You have no employment by Warner Brothers or any connection with Warner Brothers other than as a member of the Board of Directors, have you?

A. No, that is correct. I haven't had for a great many years.

(Deposition of Waddill Catchings.)

Q. In addition to that, you also have other interests outside of Warner Brothers which take up your time?

A. Oh, well, I am actively in business in the [784-69] production of radio programs at the present time.

Q. The only connection you have is, in getting money from Warner Brothers, that you get a director's fee occasionally?

A. I do, yes, it has been rather occasionally in the past; recently it has been more frequent, but for many years it hasn't been much. Directors do not receive salaries from Warner Brothers. They get a fee of $50 for attending a Board meeting.

Q. Now, Mr. Catchings, I direct your attention—incidentally, so that there may be no misunderstanding about this, I had a talk with Mr. Catchings a day or so ago and went over these various meetings with him so as to refresh his recollection as to the meetings.

I call your attention now to a meeting of the Board of Directors of Warner Bros. Pictures, Inc., which was held on the 25th of September, 1945, and in order to refresh your recollection as to the particular meeting concerning which I am going to question you, I want to say that at that meeting the resignation of Joe Bernhard as Vice-President and Director of Warner Brothers was tendered to the directors. That sufficiently identifies the meeting for you, does it? A. Yes.

Q. Do you remember at that time whether in

(Deposition of Waddill Catchings.)

connection [784-70] with the presentation of Mr. Bernhard's resignation, any statement was made concerning the reasons for his resignation?

A. Yes. He was resigning to go into the production of motion pictures. A corporation was being formed jointly by him and Milton Sperling. I think it was called the United States Pictures Corporation.

Q. At that time the directors did, as the record shows, accept his resignation? A. Yes.

Q. Was there anything said at that time as to who Milton Sperling was? A. Yes.

Q. What was stated in that regard?

A. He was stated to be a son-in-law of Harry Warner's, but that was well known anyhow, and it was stated that he was going into the business with Joe Bernhard and that the two were to engage in business together and they were going to make some contract with Warner Brothers under which they would have the use of Warner Brothers' facilities on the same terms, or generally speaking the same terms, as prevailed with respect to other independent producers that worked on the Warner lot.

Q. In connection with your vote on this measure, I take it from the minutes that you voted to accept the [784-71] resignation? A. Yes.

Q. Did anybody at that time, or in connection with it, state to you how you should vote?

A. No.

(Deposition of Waddill Catchings.)

Q. When you did vote, did you do so in the exercise of your own independent judgment?

A. I did.

Q. I call your attention to a next meeting of the Board of Directors, which was held just three days later on the 28th of September, 1945, at which the record shows that you were present and at which time, in order that you may identify the meeting, a proposed contract between Warner Bros. Pictures, Inc., and United States Pictures, Inc. was presented to the Board for consideration. I ask you whether you have any recollection of what transpired at that meeting.

A. Well, there was a brief outline of the terms of the contract and there was quite a little discussion with respect to the contract, what it covered and the commitments that the company was making, the commitments that were being made to the company.

Q. Do you remember any of the details of that contract?

A. No. It wouldn't be possible for me to remember [784-72] back that far the details of a contract.

Q. Do you have any recollection as to whether Warner Brothers were to put up any of the financing for that deal? A. No, I do not.

Q. Do you remember what the division of profit was to be in connection with the matter?

A. No.

Q. Now, at the time was the matter——

A. I knew it at the time.

(Deposition of Waddill Catchings.)

Q. Yes, I appreciate that. At the time was there a considerable discussion about the terms of the contract? A. Yes, there was.

Q. Do you remember whether Mr. Friedman was present at that time?

A. Yes, he was, and I think he presented quite a summary of the terms of the contract.

Q. At the time you voted on that contract—I take it you did vote in favor of authorizing the entering into the contract? A. I did.

Q. Did any person say to you in what way you should vote on that matter? A. No.

Q. When you voted, did you exercise your own independent judgment as to the manner in which you should vote? [784-73] A. I did.

Q. Did you consider that contract to be a good contract from the business viewpoint for Warner Brothers? A. I did.

Q. Incidentally, was there anything said either at that meeting or at the preceding meeting on the subject of Milton Sperling, as to whether he had had any experience in the production of motion pictures?

A. Yes, I think he was—I think that so far as I am concerned, I think I knew it before that, but I think it was covered in the meeting that he had met with considerable success in work for other moving picture companies and was a very promising young person in the moving picture business.

Q. And you had that information when you voted on this contract? A. Yes.

(Deposition of Waddill Catchings.)

Q. I now call your attention to a meeting which was held—incidentally, I almost overlooked something. You were out on the Pacific Coast and in and about Los Angeles immediately prior to this meeting of the 25th of September, were you not, or shortly prior to that?

A. Well, I had been out there on so many occasions that I don't know—I would have to look up some records to tell whether I was out there just prior to this. But I have been going to Hollywood in connection with Warner activities repeatedly over a long period of time.

Q. Let me ask you this: Do you remember having had one or more conversations at or about this time with Mr. Harry M. Warner in Hollywood and perhaps here in New York in which there was some discussion about this proposed contract or this contract with United States Pictures and Sperling and Bernhard?

A. I think that the discussions at that time with Harry Warner occurred in New York with respect to Sperling and Bernhard. He was here some time before that meeting, and whether he talked to me at that time or not, I don't know. But he was here shortly after the meeting and he went over the thing at considerable length, covering much the same ground that had been covered in the statements that were presented to the Board.

Q. Do you have any recollection of anything that he stated as to the reasons why he believed that the making of such a contract by Warner Bros.

(Deposition of Waddill Catchings.)

Pictures, Inc., with United States Pictures, Inc., would be a good thing for Warner Brothers?

A. Yes. He had great confidence in the ability of Joe Bernhard, as we all did. I had known Joe extremely well for a period of years and had a very high regard for him, and high expectations were held as to the success that would [784-75] come from the exercise of his abilities in the production of pictures; and also the fact that working under a man such as Joe, a man with such ability as Joe, that Milton Sperling would develop very rapidly in accordance with the promise that he gave from the work that he had already done.

It was thought that training under Joe would be very, very beneficial to Milton and his growth and development.

Q. Was there anything said as to what interest Warner Brothers might have in the growth and development of Milton Sperling?

A. It is very hard, Mr. Williams, for me to say how much I knew at that time and how much I knew later than that time, because you can't divide your memory up into sections like that. As far as I know, from the time that these arrangements were made with Milton, I had high hopes that Milton would grow to be a very important person on the Warner lot who would have real possibilities of high executive position in the course of time.

Q. Was anything said to you by H. M. Warner or any of the other officers of Warner Brothers at that time about the desirability of having somebody

(Deposition of Waddill Catchings.)

on the Warner lot with such experience that he would be able to take over in case anything happened to Jack Warner?

A. Oh, yes, that was certainly the subject of discussion. [784-76] I think I ought to say here that it has always been a deep conviction of mine that a man could not develop for headership in a company under someone else, that—I mean, to succeed them, that he had to have responsibility of his own, and I thought that the conditions that we created with respect to Milton would give him a chance to *drow* if he had in him the qualities that he appeared to have, and grow in a way that would be much better than if he were acting as an assistant or a subordinate of Jack Warner.

* * * * * [784-77]

Q. (By Mr. Williams): The next meeting was the 23rd of November, 1945, and on that date a meeting was held in reference to an amendment, or amendatory letter, having to do with the clarification of the fact that in case United States Pictures borrowed money from any bank or banks, that that money was to be paid back to the banks by Warners before they got any money out of it themselves?

A. Yes.

Q. You remember the circumstances of that meeting?

A. Well, I have seen those minutes recently and that refreshes my recollection. I don't remember it apart from that.

Q. At any rate, you do remember that the mat-

(Deposition of Waddill Catchings.)

ter had to do with a small amendment in connection with the bank loan?

A. Yes, I remember that very well.

Q. And at the time you voted in favor of the subject? A. Yes.

Q. At that time, or in connection therewith, did any person say to you in what manner you should vote on that? A. No.

Q. And when you did vote, you used your own independent judgment in the matter?

A. Yes. [784-78]

Q. I call your attention next to a meeting that was held on the 18th of June, 1946, at which it appears that you were present and at which there was presented to the directors a matter of a change of the terms of the basic United States Pictures Company agreement with reference to a picture called Pursued, and the organization of a corporation called Hemisphere Films, which was the corporation in which Niven Busch, the author of the picture Pursued and Teresa Wright, the star that was proposed to be used in the picture, should be stockholders. Do you remember the circumstances of that matter being brought before the Board?

A. Well, I have examined those minutes and, with the aid of the minutes, I recall that it took place; but I couldn't have done it without seeing the minutes.

Q. Well, do you remember now, having refreshed your recollection, that at that meeting the matter was discussed and that it involved Warner Brothers

(Deposition of Waddill Catchings.)

taking a smaller proportion of the profits, but on the other hand getting a larger proportion of the distribution costs and overhead? A. Yes.

Q. Do you remember whether at that time there was presented to the Board an analysis of some figures based on assumed grosses that Mr. Carlisle had presented, discussing what the probable profits to the corporation *would* [784-79]

A. Well, that was common practice, but remembering whether the thing was done specifically, I mean, I can't imagine it was omitted, but I can't go back after all this time and say that I would specifically recall that particular thing having been presented.

Q. Well, the record shows that this was adopted unanimously, and I take it that you voted for the change? A. I did.

Q. In doing so, you used your own judgment and were not dictated to by anybody else?

A. That is correct.

Q. I now call your attention to a fact which has come to light in connection with a contract which has been referred to here as the letter agreement of December 6, 1947, and which was identified on May 3, 1949, in connection with the discovery proceedings as Plaintiff's Exhibit 6. This an agreement which provides for the production of four additional pictures. The original contract, as you will remember, provided for the production of six pictures, and it involved a distribution of the profits, 50 per cent to Warner Brothers and 50 per

(Deposition of Waddill Catchings.)

cent to United States Pictures; it also provided that Warner Brothers would share half of the cost of producing the pictures and that the domestic distribution fee should be 20 per cent.

Now, this letter of December 6, 1947, was not at [784-80] that time presented to the Board of Directors but was executed on behalf of Warner Bros. Pictures, Inc., by R. J. Obringer, Assistant Secretary. It provides in substance that Warner Brothers shall put up the entire cost of four additional pictures, without reference to the first group of pictures; that the overhead to be charged to United States Pictures will be enlarged and increased; that the domestic distribution charge will be increased from 25 to 25 per cent, with some additional increases for foreign distribution; and that upon the distribution of the picture, the profits, after paying off all costs and distribution charges, will be divided 80 per cent to Warner Brothers and 20 per cent to United States Pictures.

Now, with that in mind, I call your attention to the fact that on the 17th of August, 1950, there was held a special meeting of the Board of Directors of Warner Brothers at which a third amendment providing for three additional pictures on top of these four additional pictures was presented to the Board, the conditions of production of the three additional pictures being substantially the same as those of the four additional pictures. Do you remember that matter being brought before the Board on or about the 17th of August, 1950?

(Deposition of Waddill Catchings.)

A. Well, with the same qualification that I made before, that the fact that it is recorded in the minutes [784-81] I used that to refresh my recollection. I do not have to have my recollection refreshed with respect to the two transactions, because I have a recollection that I was in Hollywood at some time prior to this meeting in 1950, and possibly in 1947, and that I knew at the time what was being done with respect to enlarging or adding to the activities of Milton Sperling there on the Warner lot. I have a very vivid recollection of having been present in Harry Warner's office at a meeting between Harry and Milton Sperling with respect to modifications in the contract, as I was in Hollywood at the time, and Harry told me he was going to have a talk with Sperling and invited me to come and sit in his office while the discussion took place. That I remember very vividly, because I had never had a chance of seeing Milton Sperling in action, so to speak, and the manner in which he conducted the discussion with Harry, his thorough fairness, made a very lasting impression on me. It was the first time I came to know much of the man, of the ability that he undoubtedly has. Before that I had to take it more or less on hearsay.

Q. That was prior to this meeting of August 17, at which the matter came up before the board?

A. You are talking about August 17, 1950?

Q. Yes. [784-82]

A. Oh, yes, it was some time prior to that, and while I am not certain as to just when it occurred

(Deposition of Waddill Catchings.)

in Hollywood, I should say that it occurred somewhere around 1947.

Q. I will show you now these minutes of August 17, 1950, and it is only necessary for you to refer to the last page, Mr. Catchings, because that is the only part that deals with this subject, and ask you to examine those minutes and refresh your recollection from that examination. Then I will ask you some questions.

(The witness examined the minutes referred to.)

Q. You have now examined the minutes. I will ask you whether you now remember that the matter of the approval by the directors of the change that had been made in the contract was brought before the board and passed on. A. Yes.

Q. And you voted in favor of it?

A. Yes.

Q. And at the time you voted in favor of it, did you do so of your own independent volition, without any suggestions or statements from other persons? A. Yes.

Q. And this vote by you was after you had known of the pendency of these changes through having participated, at least as a spectator, in the conferences between [784-83] Milton Sperling and Harry Warner?

A. I participated more than as a spectator. I was there as a director of the company, but I didn't engage in the discussions.

(Deposition of Waddill Catchings.)

Q. And you did personally approve of the changes in the contract?

A. Oh, very definitely.

Q. Let me ask you this, Mr. Catchings: I preface it by saying, of course, this company is Warner Bros. Pictures, Inc., and Harry Warner is president, Major Albert Warner, Vice-President, J. L. Warner is Vice-President, all of them are directors, and Harry Warner is the executive head of the company, and Major Albert Warner is the Treasurer, and Jack Warner is the head of production; naturally, you think of the Warner Company.

Let me ask you this: You have been a member of the Board of Directors of this company for almost thirty years. At any time have any of the Warner brothers undertaken to direct you as to how you should vote in reference to any matter that came before you as a director of this corporation? A. Certainly not.

Q. In its inception you came on to this board as a representative of the public stockholders?

A. That's correct. [784-84]

Q. And you have had, I think you stated, a very large experience as a director of many publicly held corporations? A. That is true. * * * * *

Q. Will you state as to whether, in voting upon any of these matters as to which you voted, Milton Sperling's being a son-in-law of Harry Warner was given consideration by you in connection with the contracts?

A. Well, I knew that he was a son-in-law of

(Deposition of Waddill Catchings.)

Harry Warner, so I couldn't fail to give consideration to the fact; but it certainly did not influence my voting in favor of any of the contracts.

I would like to put the answer in the negative, and that is that I can conceive of no reason why I should vote against Milton Sperling because he was a son-in-law of Harry Warner. [784-85]

Q. Well, state just as frankly as you can what your attitude toward the situation was in view of the fact that Milton Sperling was a son-in-law of Harry Warner's.

A. Well, Milton Sperling, as I have said repeatedly in my testimony here, was a very able young man and there was certainly no reason, because he was related to Harry Warner, in my opinion for voting against him. As a matter of fact, the close relationship which existed between him and Harry Warner was much in his favor, as far as I was concerned, because Warner Brothers was conceived and always has been and is today, a family company. It is run by the three Warner brothers, the executive end of the business, and its great strength and its magnificient growth has been a result of the splendid and harmonious relationship which has existed between the brothers as members of the family, and I think Warner Brothers is somewhat unique in that respect, that it is a great pulbic corporation and yet it is a family company.

Q. What did you have in mind in connection with Milton Sperling's relation to Harry Warner being an advantage to the corporation?

(Deposition of Waddill Catchings.)

A. I mean by that that Milton saw a great deal of Harry, and Harry had a great deal of confidence in him, and Harry's team, in running the company, was a team at the top composed of members of the Warner family and if you [784-86] could have a man of great ability added to the team, who was also a member of the Warner family, even as a son-in-law, it seemed to me to be a strong point in his favor.

Mr. Williams: I have no further questions.

Cross Examination

* * * * *[784-87]

Q. (By Mr. Pottish): You do not have any large stockholdings in Warner Bros. Pictures?

A. No, I haven't personally.

Q. Is it a fact that from year to year, when the Board of Directors of Warner Brothers is put forth, the slate is put forth by a Nominating Committee?

A. I don't know that there has been a formal Nominating Committee.

Q. Well, are you familiar with the mechanics whereby each year, at the annual meeting of stockholders, a slate of directors is presented to the public stockholders for voting?

A. I certainly am familiar with that, but that is [784-90] by action of the Board of Directors itself. It selects the nominees to be submitted in behalf of the company to the stockholders.

Q. The existing Board of Directors selects the

(Deposition of Waddill Catchings.)

slate which will be presented at the next meeting of the stockholders?

A. Yes. Well, but it is presented to the Board prior to the meeting.

Q. Yes. Isn't there some Executive Committee which has some control as to who shall be named in that slate?

A. I don't know of any.

Q. Is it a fact that the three Warner brothers, or the Warner brothers' family controls the slate of directors which is annually presented to the stockholders?

A. I wouldn't say that. I should say that it is the action of the Board of Directors. There have been changes made in the Board of Directors from time to time, and they have been discussed among the directors. I have never felt that the Warner brothers were dictating to me as a member of the Board as to what names to submit to the stockholders. Each year there comes a time when we appoint a proxy committee, and when we authorize the calling or the solicitation of proxies and the submission to stockholders of a list of candidates, and that is a matter of discussion in the Board, and the Warner brothers [784-91] express their opinion, and anybody else that has any opinion is entitled to express it, and I can say to you positively that I think if there was any objection to anybody, that they wouldn't be submitted.

The Warner Brothers' Board has not been a Board of divided action; it has been one of the fine

(Deposition of Waddill Catchings.)

qualities of Harry Warner and his leadership of the company to devise his policies in accordance with the advice that is given to him and his knowledge of the attitude of the Board of Directors. I think he has shown as much deference to the outside men that are on the Board of Directors as any corporate head I have ever known.

Q. But am I correct in saying that it is considered that the leadership of the company lies with the Warner brothers and their family?

A. Well, I covered that quite fully a while ago, I say that so far as the corporation leadership is concerned, the corporate leadership is of the officers of the company, which is precisely the same as every other corporation I have ever been on.

Harry Warner speaks not as a member of the Warner family but as the President of the company, when he is addressing a recommendation to the meeting.

Q. Well, you know, do you not, that the Warner brothers control a large block of stock in the company? [784-92]

A. Yes, that is public knowledge, I think.

Q. And would it be an unfair statement to say that if the Warner brothers desired to keep somebody off the slate, that there would be no question about the fact that such person would be kept off the next slate of the Board of Directors?

A. I wouldn't say that was so. I think that it is purely a matter of speculation as to what would happen if there was a difference of opinion between

(Deposition of Waddill Catchings.)

the Warner brothers and those of us who are not connected with the company or members of the family. That situation has never arisen. But I have never seen any indication of a desire by Harry Warner to force upon the Board of Directors any nominees that were not agreeable to the Board.

Q. Would you feel as though you would be willing to act on the Board of Directors against the opposition of the three brothers?

A. You mean would I be willing to oppose them in the Board?

Q. No, no, that is not what I said. I said: Would you feel that you would want to act as a director if you were advised by the three Warner brothers, prior to a coming election that they preferred that you no longer act as a director?

A. Well, I don't know. That is a speculative [784-93] question. There might very well be circumstances where I would want to get off. But on the other hand, the circumstances might be such that I would want to put up quite a fight. I have had this rather long experience in business and on Boards of Directors, as I have testified here, and that situation has never arisen in any company, and just what I would do under those circumstances, I can't tell. I used to think, when I was on the Board of Directors of Goldman, Sachs & Company, that I didn't need anybody else on the Board except me, that I didn't care how many other people there were, if I were right I could persuade the Board of Directors to act the way I thought they should,

(Deposition of Waddill Catchings.)

and I always did, and I didn't want any lieutenants or anybody there. I have always found the executive heads of companies responsive to reasonable argument.

So when you ask me what would happen if I were opposed to something the Warners said, it is just inconceivable to me that that situation would develop.

Q. Well, my point is this: Do you feel that you could be elected to the Board of Warner Brothers over the opposition of the three brothers?

A. I think that might very well be true, if they were to take a high-handed arbitrary attitude; but I don't know whether now, as I say, in the twilight of my life, I would have sufficient influence to do it, but [784-94] certainly there have been plenty of times in the past, and if the Warners had wanted to push me around I could have formed a group that might well have pushed them around. They have never had an open and shut control; they had only started with a certain amount of stock, and there have been plenty of stockholders on the outside. * * * * * [784-95]

Q. How many members of the public—and when I say that, I mean directors similar to yourself, whose origin as directors started from representing public stockholdings—how many such public members of the Board of Directors are there on Warner Brothers' Board?

A. Well, I don't think there is any one on Warner Brothers except myself who started as a rep-

(Deposition of Waddill Catchings.)

resentative of the public. Goldman, Sachs & Company were the original bankers. Later on, Hayden Stone had something to do with Warner activities, and Dick Hoyt came on the Board as a representative of the public, but he got off in the course of time, and, so far as I know, I am the only one that ever started as a representative of the public. That does not mean that I am the only independent director on the Board. Jack Bierwirth is a man of very real and far-reaching independence in business. Charlie Guggenheimer is a well-known and successful lawyer, and Morris Wolfe is a most [784-96] character and entirely independent; I don't think anybody can control Morris Wolfe. He is a very distinguished lawyer in Philadelphia, as you know. * * * * *

Q. You testified that it was stated at that meeting that Milton Sperling was his son-in-law and that he was going with Joe Bernhard. Now, who made these presentations [784-97] or these statements?

A. Well, I think I testified a while ago that Mr. Stanleigh Friedman made a long analysis of the contract and presentation, and I think that he conducted the main part of the discussion; but statements were made—I haven't verified it from the minutes, but I imagine that Albert Warner was there and talked on the subject, and certainly later on Harry Warner was at some of the meetings and he talked plenty on the subject.

Q. If I may get back to the meeting preceding

(Deposition of Waddill Catchings.)

the meeting at which the contract was approved, and that is the meeting at which Bernhard's resignation was presented, you told us that it was stated that Milton Sperling, the son-in-law of Harry Warner, was going in with Joe Bernhard and that they were going to make a contract with Warner Brothers—and I am just giving the substance of what I think you said—on the same terms as prevailed with other independent producers that work on the Warner Brothers lot.

A. I think that is right.

Q. Now, did you have, or do you have now, any detailed knowledge of what the terms of the contracts are with other independent producers on the Warners Brothers lot?

A. No, but I have at time read them from beginning to end and have been thoroughly familiar with them. [784-98]

* * * * *

Q. Did Stanleigh Friedman at that time, do you recall, brief the Board on whether or not that contract was similar to other contracts with other independent producers and give the details of those similarities? [784-99]

A. I think he did so by reference. I think he mentioned ~~at the~~ time that it is a contract similar to such-and-such that we made with other people, then mentioning their names.

Q. At the time he said that, did you then have an independent knowledge as to whether or not the terms were identical or similar between this U. S.

(Deposition of Waddill Catchings.)

Pictures contract and other independent producers?

A. No, I said a few minutes ago, I didn't read the contract before action at the Board. I acted on the statement that was made by Stanleigh Friedman.

Q. And you relied on his statement, did you not, that the contract was similar to contracts made with other independent producers on the Warner lot?

A. Yes.

* * * * *

Q. Would you remember whether or not, at that meeting, Major Warner recommended that the contract be approved? [784-100]

A. Oh, undoubtedly. He was present at the meeting, I assume.

Mr. Williams: Yes, he presided.

The Witness: He undoubtedly recommended it.

Q. Did that carry weight with you in your own mental deliberations as to whether the contract should be approved?

A. Well, he was transmitting a recommendation from the Coast, as we call it, with respect to this contract, and I don't think that anything that Major Warner said added anything. He was presenting the recommendations of his two brothers, H. M. and J. L., and they were the ones who were primarily concerned with the contract.

Q. Did that recommendation mean something to you? A. It did.

Q. Would you say that you placed a lot of faith in the recommendations from the Coast?

(Deposition of Waddill Catchings.)

A. Oh, yes. I don't know how to run the company from New York without placing faith in the recommendations from the Coast.

Q. Was that pretty much, do you think, the belief and actions of the other members of the Board, too?

A. Well, I can't testify about the other members of the Board. [784-101]

* * * * *

Q. You testified too, Mr. Catchings, that you had some conversations, or at least one conversation, with H. M. Warner in New York concerning Sperling and Bernhard, but as I recall, you testified you did not recall whether that conversation was before or after the meeting of September 28, 1945.

A. I think that I said that it occurred after that time.

Q. After the meeting? A. Yes.

Q. And at that time you got the impression from H. M. Warner that he thought it was a good contract? A. Yes.

Q. And he spoke highly of Mr. Bernhard and the help he would be in making a success of that venture for you at pictures?

A. Yes. He was particularly emphatic upon the benefit to Milton as a young man in growing up under the very real wisdom of Joe Bernhard. Joe Bernhard had not spent his life in the moving picture business, as you know; he had come into Warner Brothers from real estate activities, as far as

(Deposition of Waddill Catchings.)

I recollect, and had been extraordinarily successful in his executive work here in the handling of the theatres and was a man of ripe experience and wisdom, and the emphasis was on the benefit to Milton, who was growing up in the motion picture business, of association with Joe, not because of what Joe knew about the making of pictures, but what Joe knew about the world, and life, and his general executive ability. [784-103]

* * * * *

Q. Well, at any time prior to the approval at any of these meetings of these subsequent amendments to the basic agreement, had you made any independent investigation [784-105] as to how the contract was working out?

A. Well, I don't make any independent investigation. I had information from Carlisle from time to time as to how the pictures were turning out. I have been pretty well informed as to what pictures were successful and how much money we were making on them, and things of that sort.

Q. Did you at any time prior to these amendments investigate or exercise any surveillance over the administration of the contract with regard to the amount of overhead that was being charged by United States Pictures? A. Oh, no.

Q. As its share?

A. Oh, no. That is entirely outside of my function as a director. * * * * * [784-106]

DEPOSITION OF C. S. GUGGENHEIMER

Plaintiff's Exhibit 117. Deposition of Charles S. Guggenheimer, a witness called by and in behalf of the defendants, taken pursuant to Stipulation dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 17th day of May, 1951, before Arnold Schubert, a Notary Public of the State of New York. [784-109]

* * * * *

Direct Examination

Q. (By Mr. Williams): Mr. Guggenheimer, what is your occupation or profession?

A. Lawyer.

Q. How long have you been practicing law?

A. I was admitted in 1899.

Q. And you have been practicing all that time in New York City, have you, Mr. Guggenheimer?

A. Yes, sir.

Q. You are a member of what firm?

A. Guggenheimer & Untermyer, in New York, and Guggenheimer, Untermyer, Goodrich & Amram, in Washington, D. C.

Q. Your work has involved your being attorney for and director of and officer of many corporations, I take it?

A. That is correct. [784-110]

Q. And has covered that entire period from 1899 up to the present time, with, I can assume, a little less activity in the earlier years?

A. A little less activity so far as being a director, and so forth, is concerned; very much less.

(Deposition of Charles S. Guggenheimer.)

Q. But during the major portion of your career as a lawyer, you have had close connections as director and officer and attorney for many corporations? A. Yes, sir.

Q. And you are now a director of Warner Bros. Pictures? A. I am.

Q. And have been for how many years?

A. The early '30's; I don't remember exactly whether it is '31, '32; it was the early '30's.

Q. Your firm has now and from time to time has had some connection with Warner Bros. as attorneys for them in certain matters?

A. We have.

Q. You have been from time to time and now are under retainer from Warner Bros.?

A. We are on a retainer from them today.

Q. Warner Bros. are not your principal client by any means, I take it?

A. No. [784-111]

Q. And your professional connection with Warner Bros. is not by any means your means of making a livelihood? A. It is not.

Q. Do you have any office or employment with Warner Bros. other than director, except for the retainer it pays your firm? A. None.

Q. You never have had? A. Never.

Q. Have you made it a practice of attending practically all of the meetings of the Board of Directors of Warner Bros. Pictures, Inc.?

A. I would say yes.

Q. Now, I call your attention specifically——

(Deposition of Charles S. Guggenheimer.)

Mr. Williams: And I may say for your benefit, Mr. Pottish, that within the last few days I have gone over these minutes with Mr. Guggenheimer with the idea of bringing his mind to the subject under discussion and refreshing his recollection so far as it may be refreshed from examining the minutes, and I will therefore ask leading questions about some of these meetings.

Q. Do you have in mind the meeting of the 24th day of September, 1945, of the Board of Directors, which I can further identify for you by saying it was the meeting at which the resignation of Joe Bernhard was acted upon by the [784-112] Board?

A. I have a distinct recollection of that meeting.

Q. You were present at that meeting?

A. I was.

Q. And voted on the resolution involving Mr. Bernhard? A. Right.

Q. Do you remember whether at that meeting, in connection with that matter, there was any statement made by any person with reference to the reason why Mr. Bernhard was resigning from Warner Bros.?

A. It is my recollection that Mr. Bernhard—I asked Mr. Bernhard personally, and he told me he had three sons—I think three—and that he wanted to look to their future, and he thought that he would be a producer and that this sons would have a business that they could inherit.

(Deposition of Charles S. Guggenheimer.)

Q. Do you remember anything being said with reference to his entering into a business with Milton Sperling, the son-in-law of Harry M. Warner?

A. Yes. Whether, frankly, it was that meeting or before or after, I don't know, but I distinctly recall hearing that; the United States Pictures, I think, was the name.

Q. At that meeting the resignation of Mr. Bernhard as an officer and director of Warner Bros. was accepted? A. It was. [784-113]

Q. You voted favorably to accepting that resolution? A. I did.

Q. In connection with your vote, did any person state to you how you should vote or indicate a desire that you should vote one way or another on that motion? A. No.

Q. In casting your vote, did you use your own independent judgment as to the matter?

A. Very definitely.

Q. I now call your attention to a meeting which was held three days later by the directors of Warner Bros., and when I say Warner Bros. I always mean Warner Bros. Pictures, Inc., at which you were present and at which there was presented a contract proposed to be executed between Warner Bros. and United States Pictures, Inc. Do you remember the occasion of that contract being presented to the Board?

A. I remember a meeting at which a contract was submitted, yes.

Q. Do you remember whether at that time there

(Deposition of Charles S. Guggenheimer.)

was anything said on the subject of the connection, if any, of Joseph Bernhard and Milton Sperling with United States Pictures, Inc.?

A. Yes, I think there was.

Q. What do you remember that was said on that subject? [784-114] What, if anything, in connection with it?

A. That they were United States Pictures.

Q. Do you remember whether the contract was explained by any person there? Were the terms of the contract stated by any person there?

A. Yes; I think they were. It is my impression it was Mr. Friedman who discussed it, stated the terms of it, and so forth.

Q. Do you have any recollection now as to what the terms in general were?

A. Very general. They were to make a certain number of pictures; the company was to—as I say, I am speaking completely from recollection; that is how long—six years ago, isn't it?

Mr. Pottish: That's right.

A. (Continuing): The company was to advance a certain part of the cost of the picture; they were going to make some bank loans or something, and the loaners were to get their money back before profits were taken, and then profits were to be divided in some way. Now, that is my recollection of the thing in general.

Q. Do you know whether at the time Mr. Friedman did explain the terms of the contract in detail?

A. I think he did, very definitely in detail.

(Deposition of Charles S. Guggenheimer.)

Q. After the matter had been discussed, it was voted [784-115] on. Did you vote favorably to authorizing the execution of the contract?

A. I did.

Q. At that time did you do so in the exercise of your own independent judgment on the matter?

A. I did.

Q. Did anybody state, directly or indirectly, to you, that you should vote in any particular way in the matter? A. No.

Q. I call your attention to the fact that on the 23rd of November, of the same year, 1945, there was a directors' meeting held at which Mr. H. M. Warner was present, among others; at which there was presented a short letter agreement which constituted an amendment of the United States Pictures-Warner Bros. contract having to do with the one subject that the amount of any loans from banks should be deducted from the moneys payable to United States Pictures and turned over to the bank by Warner Bros. Do you remember the circumstances of that matter coming before the Board?

A. I will say yes. I remember several amendments of it. Dates I do not remember. There was this, and then I think there was even a subsequent amendment.

Q. That is correct. Now, as to this particular matter, the record of the meeting shows that it was resolved. [784-116] Did you vote in favor of that resolution? A. I did.

(Deposition of Charles S. Guggenheimer.)

Q. And in doing so, did you exercise your own independent judgment? A. I did.

Q. Was there any statement made to you by any other person that you should vote in any particular way on that matter? A. No.

Q. Now I direct your attention to a meeting of the directors of Warners Bros. which was held on the 18th of June, 1946, the following year, at which there were present Mr. H. M. Warner and Jack Warner and Albert Warner and the other directors, including yourself—no, they were not all present; Albert Warner was present but not Harry or Jack.

Mr. Pottish: Excuse me, what was the date there, please?

Mr. Williams: This is the 18th of June, 1946.

Q. (Continuing) This is a meeting concerning a motion picture, the name of which was Pursued, and the proposal was that there should be an amendment to the basic United States Pictures-Warner contract with relation to that picture only. There was a writer named Niven Busch and an actress, a star, a motion picture star named [784-117] Teresa Wright, who was organizing a corporation known as Hemisphere Pictures, and they proposed to make a deal with United States Pictures which United States Pictures in turn would treat as a contract with Warners under the basic distribution and production agreement. Under the terms of this amendment, referring to this individual picture, Warners would receive only one-third of the net profit; on the other hand, the dis-

(Deposition of Charles S. Guggenheimer.)

tribution charge would be raised from the 20 per cent provided in the basic agreement to 25 per cent, and the amount of overhead would be increased.

Do you remember the discussion of that particular contract?

A. I remember the name of the picture Pursued. I do not remember the actual discussion in connection with it.

Q. Do you remember that at the time the matter was voted on there was some discussion and explanation of the matter to the Board?

A. Yes.

Q. And you voted, did you, in favor of that amendment? A. I did.

Q. In so doing, did you exercise your own independent judgment in your vote?

A. I did.

Q. Were you at that time directed or requested by any person to vote in any particular manner on that issue? [784-118] A. No.

May I just interrupt for just a moment to say this: At no time since 1932, when I have been on the Board, has anybody asked me to do anything in the way of voting or not voting, and if you go through all the records you will find that I have on some occasions voted diametrically opposite to the Warners and to everybody else. On one occasion, as I recall it, I was the only one who voted against it. I mean, I am glad to answer that each time, but that goes. They just have never asked me to vote.

(Deposition of Charles S. Guggenheimer.)

As a matter of fact, Harry Warner came to me and congratulated me on my independence.

Q. Mr. Guggenheimer, without the necessity of repeating it, we can regard it as being your testimony——

A. I am perfectly satisfied that you should; I am just calling your attention to it.

Q. We can probably save time. We can take it, then, that with reference to any meetings involved in this United States Pictures deal, that no person did make any suggestions, requests or directions as to how you should vote on any of the matters?

A. Definitely not.

Q. Now, I direct your attention to a meeting of the directors of Warner Bros. which was held on the 17th of August, 1950, and I recite, in order to refresh your [784-119] recollection about the matter, that on or about the 6th of December, 1947, there had been executed an agreement, which has been identified in this record as being the Exhibit No. 6 attached to the discovery proceedings on the 3rd of May, 1949, and that is an agreement which provided for the making of four additional pictures by United States Pictures. The original contract provided for the making of six pictures on the basis of Warner Bros. putting up half the cost, United States Pictures putting up half the cost, which they might borrow in whole or in part from banks, provided that after the banks had been paid and Warner Bros. had been paid, and after a distribution fee of 20 per cent had been deducted,

(Deposition of Charles S. Guggenheimer.)

and other expenses and costs had been recovered, that the net profits of each picture were to be divided fifty-fifty between Warner Bros. and United States Pictures. It provided for six pictures.

Now, on the 6th of December, 1947, as I have said, an amendatory agreement was executed which provided for the making of four additional pictures, or they were called additional pictures. Those pictures were to be produced on different terms: Warner Bros. was to put up the entire cost of production; the distribution fee was to be raised from 20 per cent to 25 per cent domestic; the British distribution was to be raised from 25 to 30 per [784-120] cent, and all of the other foreign was to be at 30 per cent; provision was made that Warners were to receive 80 per cent of the net profit and United States Pictures were to receive 20 per cent of the net profits. In all other respects the contract was to be subject to the terms of the basic agreement.

Then in 1950, on July 21st, a second amendment was made providing for the making of three additional pictures and extending the terms within which the pictures might be made. The last three pictures were to be produced on the same terms as the four additional pictures. By means of the series of contracts, that made a complete contract under which United States Pictures were to produce six pictures under the basic agreement, seven additional pictures, making thirteen in all, some of which had already been produced.

(Deposition of Charles S. Guggenheimer.)

Now, at this meeting of the 17th of August, 1950, this matter was brought before the Board of Directors, and I direct your attention particularly to the last page of the minutes of the meeting of that date, because the last page is the only portion that refers to this specific transaction, and ask you to read that. [784-121]

* * * * *

A. Yes, sir.

Q. Now, Mr. Guggenheimer, having had your recollection refreshed by what I have said and by reading the portion of the minutes referred to, referring to this matter, do you remember that at this meeting the matter was brought up before the Board of Directors, the matter of these additional pictures?

A. There was that matter brought up. I notice from the minutes—I am relying on the date of the minutes—I would say it was at that time. Frankly, I have no independent recollection of the date.

Q. You do have an independent recollection of the substance of the matter having been brought up?

A. I do, very definitely.

Q. Was that matter discussed by the Board members at that time? A. Yes.

Q. Thereafter a vote was taken, which, according to the minutes, acted favorably upon the amendment? A. That is right.

Q. Did you vote favorably to that matter?

A. I did.

Q. Was it your independent vote at that time?

(Deposition of Charles S. Guggenheimer.)

A. Definitely. [784-123]

Q. Do you remember what, if any, discussion was had, what matters were brought to your attention at that meeting before you voted?

A. You mean particularly did we discuss this contract?

Q. Well, that is what I had in mind. Do you remember if there was discussion of the contract?

A. Oh, very definitely.

Q. Do you remember what the particular discussion was?

A. Well, it was on an extension of time, wasn't it, to finish the pictures and also to make some new ones, and there were still some pictures unproduced on the original contract.

Q. You, at any rate, having heard the discussion, were favorable to taking that action?

A. I was.

Mr. Williams: You may cross examine.

Cross Examination [784-124]

* * * * *

Q. (By Mr. Pottish): Do you recall whether or not at the time you voted to approve the original agreement back on September 28, 1945, whether you then had an independent knowledge of whether the terms of this contract between Warner Bros. and United States Pictures were similar to the terms of other contracts with other independent producers that were working on Warners' lot?

(Deposition of Charles S. Guggenheimer.)

A. I did not know that it was similar or not. It seemed a fair contract.

Q. You say it seemed fair, but it would not be in the sense that it seemed fair in comparison with other contracts you knew about, would it?

A. I knew of no other contract at that time.

Q. At this meeting of September 28, 1945, do you [784-125] recall that either Mr. Friedman or Major Warner, or both of them, after either one or both explained the contract, recommended the contract as a good one?

A. I have no such recollection.

Q. Was it customary for a recommendation on an important matter, before a meeting over which one of the Warners was presiding, for the Warners to make a recommendation to the Board?

A. I do not recall ever having heard a recommendation from Major Warner. He has explained things, discussed them, talked over things, but when it comes flatly to say, "I recommend so-and-so," he may have, but I just have no recollection of it. [784-126]

* * * * *

Q. Sticking, if we may, to this August 17, 1950, meeting, had you prior to that time made any investigation on your own as to the administration of the contract as it had existed theretofore and how it was working out?

A. They explained to us, I believe, how many pictures [784-129] had been produced under it.

Q. Well, if I may be more specific.

(Deposition of Charles S. Guggenheimer.)

A. Or how many were still due, or something.

Q. Had you, to be more specific, made any independent investigation on your own as to how the contract was being administered with regard to how much overhead charges was being allowed to United States Pictures and how much overhead charges was being allowed to Warner Bros. and whether or not the charges or allowances might or might not be fair? Did you make any such investigation? A. No. [784-130]

* * * * *

Q. Well, might I ask you if you ever actually inquired into the nature of the overhead charges that were being charged by United States Pictures to the operations under this contract?

A. No. All I tried to find out was, were they making money or were they losing money, and I understood they were making money on it.

Q. Just from the general viewpoint?

A. Yes, that is all that interested me—was the company getting a good deal? That's all.

Q. Were you familiar at the time as to the method provided under the basic contract between United States Pictures and Warner Bros. for the recouping of any losses by Warner Bros. on any one picture? A. No, I wasn't.

Q. Would you say, Mr. Guggenheimer, that you would be willing to continue as a director in Warner Bros. Pictures at a forthcoming election of directors if it were against the wishes of the three

(Deposition of Charles S. Guggenheimer.)

Warner brothers that you be on the slate of directors for that election?

A. I think that the Warner brothers, who very largely control, could nominate or possibly succeed in nominating [784-132] somebody in my place. Whether they could, if I ran independently, whether they could succeed or not, you can guess as well as I can. I wouldn't know.

Q. Would you say that——

A. I would say that I would not, if I had a fight with them—I will go further than that and say I did resign once after an argument, when I disagreed, and I was told that I was there for the purpose of disagreeing if I felt that way, and please not to resign. I mean Harry Warner himself told me that.

Q. Is it a fact, Mr. Guggenheimer, that if you felt the three Warners no longer wanted you on that Board of Directors just prior to the election of a Board, that you desist from trying to become elected a member?

A. Well, now, just a minute. You are supposing here for a minute that I originally went on because the Warners love me. I didn't know them when I first went on; I went on because I represented about $9,000,000 of debentures at that time and some seventy-five or a hundred thousand shares of the old stock, which is [illegible]00,000 shares now, and I still represent at this minute some fifty or sixty thousand shares. So that is why I am on the Board.

Q. Well, I appreciate that there is good reason

(Deposition of Charles S. Guggenheimer.)

for your being on the Board, Mr. Guggenheimer, but I still would like an answer, if I can get it, to my question. [784-133]

A. Well, you are asking me a question, would I stay on if the Warners didn't want me there. I would probably say no, unless my clients who own the shares would insist on my staying there, in which event I might make a fight. Don't forget, I do not represent the Warners directly, indirectly, or in any possible way; I have never—or any one of them. [784-134]

* * * * *

DEPOSITION OF MORRIS WOLF

Plaintiff's Exhibit No. 118: Deposition of Morris Wolf, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th St., New York, N. Y., on the 2nd day of June, 1951, at 10 a.m., before Julian Wolf, a Notary Public of the State of New York. [784-135]

* * * * *

Direct Examination

Q. (By Mr. Karp): Mr. Wolf, you are an attorney practicing in the State of Pennsylvania?

A. Yes.

Q. And how long have you been practicing law in that State? A. 48 years.

Q. And you are a member of the law firm there?

A. Yes.

(Deposition of Morris Wolf.)

Q. And what is the name of the law firm?

A. Wolf, Bloch, Schoor & Solis-Cohen. The last is one name with a hyphen between it.

Q. Your law firm handles the legal matters of Warner Bros. Pictures, Inc., in Pennsylvania and New Jersey, does it? A. Yes.

Q. That's a small part of the legal business of your [784-136] firm, isn't it?

A. It is a comparatively small part, yes.

Q. You are a director of Warner Bros. Pictures, Inc.? A. Yes.

Q. How long have you been a director of Warner Bros. Pictures, Inc.?

A. Since Warner Bros. acquired the Stanley Company of America in about 1929.

Q. And you made it a habit to attend the meetings of the Board of Directors of that corporation regularly? A. Yes.

Q. Now, do you recall having been present at a meeting of the Board of Directors of Warner Bros. Pictures, Inc., on September 28, 1945? And in order to identify that meeting, I will tell you that at that time there was presented to the attention of the Board a proposed agreement between United States Pictures, Inc., and Warner Bros. Pictures, Inc. Does that enable you to refresh your memory?

A. Not as to the date. I remember being present at the Board meeting at which that contract was presented.

Q. Now, do you recall who it was that presented

(Deposition of Morris Wolf.)

that proposed agreement to the attention of the Board at that time?

A. My recollection is that Mr. Friedman did.

Q. Mr. Stanleigh P. Friedman? [784-137]

A. Yes.

Q. And do you recall that he explained the terms and conditions of the proposed agreement?

A. I do.

Q. And do you recall that that agreement was unanimously approved by the Board at that time?

A. I do.

Q. And you voted for it? A. I did.

Q. And were you told or instructed by anyone how to vote on that occasion? A. No.

Q. You voted voluntarily? A. I did.

Q. Now, do you recall that in November of the same year there was another meeting of the Board of Directors of Warner Bros. Pictures, Inc.? And in order to identify that meeting I might say that it was purely for the purpose of amending the agreement to the extent of enabling Warners to set aside certain percentage of the moneys which ordinarily would have been due and owing to the United States Pictures, Inc., under the basic agreement, for the purpose of paying off loans that had been incurred by the United States Pictures, Inc.

A. I have a very vague recollection of that, Mr. Karp. [784-138]

Q. But do you remember having been present at the time?

A. I would not have remembered it, except from

(Deposition of Morris Wolf.)

refreshing my memory from a copy of the minutes.

Q. Yes.

A. I regard that as very formal—a pure formality and not of great significance, if I may be permitted to express a view.

Q. Do you recall having voted for the amendment at that time?

A. Well, I would not have recalled it, except that you refreshed my memory by calling my attention to the fact.

Q. Now, were you told by anyone how to vote on that occasion? A. Oh, no, no.

Q. Now, did you know prior to September 28, 1945, that Mr. Joseph Bernhard had resigned as a director of Warner Bros. Pictures, Inc.?

A. I did.

Q. Now, on June 18, 1946, there was a meeting of the Board of Directors of Warner Bros. Pictures, Inc., at which you were present. And in order to refresh your memory I have shown you a copy of the minutes of that meeting. Do you recall that at that time there was presented to the Board the proposed agreement between United States Pictures, Inc., and Hemisphere Pictures, with respect to the production [784-139] of a motion picture entitled Pursued? A. I do.

Q. And at that time a proposed amendment of the basic agreement between United States Pictures and Warner Bros. Pictures?

A. With respect to that picture?

Q. With respect to that picture.

(Deposition of Morris Wolf.)

A. Yes, I do.

Q. Do you recall having voted for the amendment? A. I do.

Q. And that it was unanimously carried by the Board? A. Yes.

Q. And again let me ask you, as I have previously asked you, whether the vote by yourself was voluntary. A. It was.

Q. And was it suggested by anyone?

A. No.

Q. Were there any instructions by anyone advising you how to vote at that time?

A. No.

Q. Now, do you recall that on December 6, 1947, an agreement was entered into between United States Pictures, Inc. and Warner Bros. Pictures, Inc., amending the basic agreement, extending the basic agreement, to 1951, and adding four pictures which were to be produced under that [784-140] agreement, also changing the agreement in the following manner: Warners was to advance 100 per cent of the costs. The profits, however, to be realized by Warners was to be 80 per cent instead of 50 per cent? A. I remember.

Q. By United States Pictures, 20 per cent?

A. I remember that that contract was made, but I don't remember when I learned that the contract was made. I don't think I knew it prior to the Board meeting at which the matter was discussed.

Q. Well, as a matter of fact, it wasn't presented to the attention of the Board in December of 1947,

(Deposition of Morris Wolf.)

but on August 17, 1950, there was a meeting of the Board of Directors of Warner Bros. Pictures, Inc., a copy of the minutes of which I previously brought to your attention, and at that time the agreement of December 6, 1947, was referred to?

A. That's right.

Q. Now, do you recall that it was also discussed by the Board at that time on August 17, 1950?

A. Well, I remember that the terms of the December agreement was then stated to the Board. I do not remember whether I had been familiar with those terms before that meeting.

Q. Well, now, do you recall that at that time on [784-141] August 17, 1950, another proposed amendment of the basic agreement was presented?

A. Increasing the number of pictures that were to be made and postponing the time for delivery, I remember that.

Q. And was that amendment carried by the Board? A. It was.

Q. Unanimously? A. Yes.

Q. And you, of course, voted for it?

A. I did.

Q. And that vote by you was voluntary and uninstructed by anyone? A. It was.

Mr. Karp: Your witness.

Cross Examination [784-142]

* * * * *

Q. (By Mr. Pottish): Did you have occasion,

(Deposition of Morris Wolf.)

prior to voting on the approval of that agreement, to study the agreement in full? A. No.

Q. Did you have occasion, prior to voting on that agreement, to have investigated the issue whether or not the agreement was the customary agreement between a moving picture company and an independent producer?

A. I have a general knowledge, after many years of being connected with the picture business, of the terms of independent agreement producing contracts, but I did not attempt to compare the individual paragraphs of this agreement with the individual paragraphs of other similar contracts.

* * * * *

Q. I believe you told us that with regard to the agreement of December 6, 1947, that first came to your attention at the meeting of the Board on August 17, 1950?

A. That's right, that is my present recollection.

* * * * *

Q. Do you feel, Mr. Wolf, that if the three Warner brothers at an ensuing election of the Board of Directors desired that you not be placed upon the next slate that you would not run or not be elected as a member of the Board?

A. I would feel that if they opposed my election, I could not force it, of course. [784-146]

* * * * *

Q. My point is, if Mr. Harry Warner alone—he is the president—— A. Yes.

Q. ——were to tell you that he no longer wished

(Deposition of Morris Wolf.)

your firm to represent Warner Bros. Pictures, why, that would be the end of it?

A. It certainly would, but I wouldn't limit that to Mr. Harry Warner. If anybody in authority told me they didn't want my services any more, I would, of course, acquiesce. [784-147]

* * * * *

Q. Well, did you exercise any surveillance over the administration of the basic contract or any of its amendments, particularly with regard to the questions of the items and amounts of overhead that were being charged by United States Pictures or being credited to United States Pictures?

A. No.

Q. You had no idea of what was happening in that regard? A. Not in that regard.

Q. Do you recall whether at the time you approved this agreement in 1945 that you were familiar with the fact that under its terms Warner Bros. could recoup a loss on any one picture only from the profits which might accrue on future pictures, and not from profits which might continue to roll in from all the pictures?

A. If I was familiar with it then, I have forgotten it now.

Q. You have no recollection now as to whether you knew that there was such a provision in this agreement?

A. I do not now have any such recollection.

* * * * * [784-148]

No. 14334

United States
Court of Appeals
for the Ninth Circuit

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,
Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC.,
Appellees.

Transcript of Record

In Two Volumes

VOLUME II.

(Pages 293 to 595, inclusive)

Appeal from the United States District Court for the Southern District of California, Central Division

(Deposition of Robert W. Perkins.)

were in charge of that phase of the company's business? A. Yes.

Q. Did you at any time, Mr. Perkins, exercise any surveillance over the administration of either the basic agreement of September 28, 1945, or any amendments thereto? A. No.

Q. Did you at any time cause anybody on your behalf, or did you yourself look into the matter of the various charges and credits which were being offered either on behalf of Warner Bros. or United States Pictures in their respective accounts under this agreement and the amendment thereto?

A. No, sir. * * * * * [784-175]

DEPOSITION OF JACK L. WARNER

Plaintiff's Exhibit No. 121: Deposition of Jack L. Warner, a defendant in the above-entitled action, taken on behalf of the plaintiff, at 3:00 o'clock p.m. on Friday, March 16, 1951, at 4000 West Olive Avenue, Burbank, California, before William H. Burgess, Jr., a Notary Public within and for the County of Los Angeles and State of California, pursuant to the annexed Stipulation. * * * * *

Jack L. Warner, a defendant herein, having been first duly sworn, deposed and testified as follows:

Direct Examination

Q. (By Mr. Lyon): Mr. Warner, I presume you have had your deposition taken several times before? A. Yes, I have.

DEPOSITION OF ROBERT W. PERKINS

Plaintiff's Exhibit No. 119: Deposition of Robert W. Perkins, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 21st day of May, 1951, before Murray Padgug, a Notary Public of the State of New York. [784-150]

* * * * *

Direct Examination

Q. (By Mr. Williams): What is your occupation, Mr. Perkins? A. I am a lawyer.

Q. Are you connected with Warner Bros. Pictures, Inc.?

A. Yes, sir. I'm general counsel for that company.

Q. And how long have you been general counsel for [784-151] the company?

A. Since 1936.

Q. Do you devote yourself in your professional work exclusively to the business of Warner Bros. Pictures, Inc., and its subsidiary and affiliated corporations? A. That is correct.

Q. Do you represent any one of the brothers Warner individually? A. No.

Q. Are you also a director of Warner Bros. Pictures, Inc.? A. Yes, sir.

Q. And you have been for how long a time?

A. I think the same length of time that I have been general counsel.

Q. Do you make it a practice to attend all of

(Deposition of Jack L. Warner.)

Q. You realize that you are under oath and will be testifying the same as you would if you were a witness in court? A. Yes.

Q. And you will have the opportunity to go over the record made of my questions and your answers and make any corrections that you deem necessary.

On the other hand, we will have the right to question you regarding any corrections that you have made.

A. Yes, I understand.

Q. What is your position with Warner Bros.?

A. I am vice president in charge of production.

Q. How long have you held that position?

A. Ever since the incorporation of the company; since 1923.

Q. Have you been a director all of that time, too? A. I have.

Q. Are your duties performed mainly in California? A. Yes, they are.

Q. Has that been so from the inception of the company? [784-178] A. Yes, it has.

Q. Do you perform any duties outside of the state?

A. Very little. What do you mean by "duties"?

Q. In connection with the corporation.

A. Yes. I am in charge of making films in London, the last few years since the quota laws of Great Britain; I supervise that work.

Q. You are in charge of making films, wherever the company makes films; is that right?

(Deposition of Robert W. Perkins.)

the meetings of the Board of Directors, unless you happen to be out of town? A. I do.

Q. I call your attention to the minutes of a meeting of the Board of Directors of Warner Bros., held on the 25th day of September, 1945, simply for the purpose of directing your attention to that date, and I will say that those minutes indicate that on that date there was submitted to the Board and accepted by the Board the resignation of [784-152] Joseph Bernhard as vice-president and director of Warner Bros., and I may say when I use the expression "Warner Bros.", unless the context shows that I mean otherwise, I mean Warner Bros. Pictures, Inc. You were present at that meeting, were you not? A. Yes, sir.

Q. Having refreshed your recollection, do you remember that the resignation of Mr. Bernhard was accepted at that time? A. Yes, sir.

Q. At the time of the presentation of his resignation, was there anything said or any conversation had by any persons at that Board meeting as to why he was resigning?

A. He was resigning to go into production.

Q. Was there any more detail than that mentioned at that meeting?

A. Why, my recollection is that it was stated that Mr. Bernhard was going into partnership with Mr. Milton Sperling in the production of motion pictures, and that it was contemplated that those pictures would be distributed by Warner Bros. Pictures.

(Deposition of Robert W. Perkins.)

Q. Was anything said at that time as to who Mr. Sperling was? A. Yes.

Q. What was stated in that regard? [784-153]

A. That he was the son-in-law of Mr. Harry Warner.

Q. Was anything said as to what his experience had been? A. I think so.

Q. Do you remember in substance what was said on that subject?

A. Well, that he had been in the motion picture business for quite a while and had been a writer and a producer for 20th Century-Fox.

Q. I call your attention next to a meeting of the directors held three days later, on the 28th of September, 1945, at which time there was submitted to the Board a proposed contract between Warner Bros. and United States Pictures, Inc. I ask you to examine the minutes, refresh your recollection thereby, and then I will ask you some questions about.

A. (Reading) Yes, sir.

Q. You were present at that meeting?

A. Yes, sir.

Q. Do you remember that at that meeting a resolution was adopted authorizing the execution of the contract that I have just described?

A. Yes, sir.

Q. Do you remember what if anything was said of and concerning that contract, its terms and provisions and by [784-154] whom, prior to the action of the Board?

(Deposition of Robert W. Perkins.)

A. Well, I remember that the contract was discussed at some length. I am quite sure Albert Warner was presiding, and my recollection is that he brought up the matter, and Mr. Friedman had with him a copy of the contract, and that after perhaps introduction of the matter by Major Warner, that Mr. Friedman analyzed the contract for the benefit of the Board members.

Q. Do you remember now any of the details of that contract?

A. No, except that it was a contract of what I suppose should be described as the general type under which an independent producer—in this case, United States Pictures, Inc.—would make a picture and turn the picture after completion over to the company for distribution on a percentage basis. I remember that the pictures were to be made on the Warner lot, and I think the pictures were to be financed in part by United States Pictures and in part by Warner Bros. Pictures. There was a percentage for distribution, and after the recoupment of the cost from the remaining proceeds of the picture, then, still deducting the percentage, the remaining proceeds were to be split between United States Pictures and Warner Bros. Pictures.

Q. Do you remember the percentage of the split? [784-155]

A. It was fifty-fifty.

Q. Do you remember that that contract was in some detail explained by Mr. Friedman?

A. I'm sure it was.

(Deposition of Robert W. Perkins.)

Q. Do you remember having noted any particular provision or provisions that at the time struck you as being unfavorable or unsatisfactory from the standpoint of the company?

A. No, sir.

Q. Subsequent to the explanation of that contract and at the time the Board approved it, did you vote favorably on the approval of the contract?

A. Yes, sir.

Q. Had you also voted favorably on the resignation of Mr. Bernhard at the meeting before that?

A. Yes, sir.

Q. Was your vote in either of these instances suggested or directed by any person other than yourself? A. No.

Q. Did you exercise your own independent judgment in voting on both of these occasions?

A. Yes.

Q. I direct your attention now to a meeting which was held on the 23rd of November, 1945, and in order to refresh your recollection as to that meeting, at which the [784-156] minutes show you were present, I will call your attention to the fact that at that meeting there was submitted an amendment to the basic agreement referred to at the last meeting, which provided in effect that from the proceeds of the distribution of any pictures made under the terms of that basic agreement, that Warner Bros. should retain and turn over to the bank which was making a loan to United States

(Deposition of Robert W. Perkins.)

Pictures such sum as was necessary to pay that loan or loans.

Do you remember the circumstances of that meeting?

A. I remember that there was a meeting some time after this meeting in December.

Q. I will show you the minutes.

A. ——which had to do with—excuse me—some problem with the arrangement with the bank.

Q. Do you now remember having examined the minutes as to just about what that particular problem was?

A. Frankly, no, Mr. Williams. I remember that I did not consider that it was a very important change.

Q. You voted in favor of it? A. I did.

Q. Did anybody direct or suggest the manner in which your vote should be cast on that?

A. No.

Q. Your vote was the result of your own independent [784-157] thought, in view of your then knowledge of what was proposed by the amendment? A. That's correct.

Q. And you do not now remember the details of that particular amendment?

A. No, sir.

Q. I direct your attention to a meeting of the directors held on the 18th of June, 1946, which had to do with an amendment to the contract with reference to a single motion picture to be produced under the contract, which picture was entitled

(Deposition of Robert W. Perkins.)

Pursued, and in order to refresh your recollection of the matter, I direct your attention to the fact that picture involved a third corporation, Hemisphere Pictures, which was a corporation in which there were the author of the screen play, Niven Busch, and the proposed star of the picture, Teresa Wright, who were to be stockholders, and under the terms of which Warner Bros. would receive only one-third of the net proceeds, and the other proceeds would be divided between the Hemisphere Pictures and United States Pictures, but Warner Bros. would receive a higher percentage for distribution; that is, instead of getting twenty per cent domestic, it would be twenty-five per cent domestic, and more for foreign, and also that Warner Bros. would receive a higher rate of overhead [784-158] on its facilities.

Do you remember that meeting? I will show you the minutes or a copy of the minutes so that you may refresh yourself as to the date and as to who was present and as to what was done there.

A. Yes, sir. I remember that there was a meeting which acted on the matter of amending the contract with United States Pictures so as to provide for a picture in which a company called Hemisphere Pictures or some such name was to produce or to participate in the production.

Q. Do you remember what reasons, if any, were stated as to why Warners should reduce its participation in the net profits from one-half to one-third in that particular case?

(Deposition of Robert W. Perkins.)

A. In general, yes. The—It was felt that the picture which was to be produced would be a valuable one, because of Busch, the writer, and Wright, the star. United States Pictures and Warner Bros. Pictures could not get the picture except on terms under which Hemisphere would produce the picture or participate in the production and would share in the profits; and the amendment which was laid before the meeting was the result of the negotiations with Hemisphere to that end; and my understanding is that the sharing arrangement, both of Warner Bros. Pictures, Inc. [784-159] and of United States Pictures, was reduced in order to meet the demand of Hemisphere, that that company also should participate.

Q. You voted in favor of that amendment, did you not? A. Yes, sir.

Q. Did any person suggest or direct how you should vote? A. No.

Q. Was your vote the result of your own independent judgment? A. Yes.

Q. And in your opinion was it for the benefit of Warner Bros. that you should have voted as you did on that and on the previous occasions?

A. Yes.

Q. I direct your attention to a letter-contract dated December 6, 1947, which was executed on behalf of Warner Bros. by R. J. Obringer, and which did not come before the Board for approval, or action at that time; in fact, was not brought to the attention of the Board officially until 1950.

(Deposition of Robert W. Perkins.)

I ask you to examine the photostatic copy I have of this contract and, having examined it, I will then ask you some questions.

A. (Reading) All right. [784-160]

Q. I call your attention to the fact that by the terms of that contract provision is made for the selection by United States Pictures of four pictures, which are designated in the contract as "additional pictures," and as to those additional pictures Warner Bros. are to advance the entire cost of production; that the distribution fee is to be raised from twenty per cent domestic to twenty-five per cent, and from twenty-five per cent British to thirty per cent, and various percentages for other foreign distribution; that the provision is made that a higher rate of overhead is to be charged for Warner's facilities to be used in the making of the pictures, and that the net profit from the distribution of the picture, after recoupment of all costs and distribution charges is to be divided eighty per cent to Warner Bros. and twenty per cent to United States Pictures.

Having that in mind, do you remember the circumstances of that amendment being brought to the attention of the Board?

A. No, I don't, Mr. Williams.

Q. Were you present at that meeting——

Mr. Pottish: Might I say at this point——

Mr. Williams: Just a minute. You are right. There wasn't any meeting, I withdraw that last question.

(Deposition of Robert W. Perkins.)

Q. You do not remember it being brought to the [784-161] attention of the Board?

A. Well——

Q. Pardon me. Were you aware of the fact——

A. Excuse me. You asked me about it being brought to the attention of the Board, the circumstances under which it was brought to the attention of the Board. That I don't remember. It is my recollection that it was brought to the attention of the Board at some time.

Q. Yes. I will ask you this: whether at or about December 6, 1947, it came to your knowledge that such a contract had been executed by Mr. Obringer on behalf of the corporation.

A. I do not recollect when, but it did come to my knowledge.

Q. Do you remember whether or not prior to any meeting of the Board in reference to it, it did come to your attention?

A. In all probability, yes.

Q. You do not remember specifically as to when it did come to your attention? A. No.

Q. I direct your attention to a meeting of the Board of Directors that was held on the 17th of August, 1950, at which a resolution was adopted, which appears on the last page of the minutes, and I ask you to examine [784-162] the minutes and particularly that last page, and thereby refresh your recollection as to that matter.

A. Yes, sir.

Q. Having refreshed your recollection by exam-

(Deposition of Robert W. Perkins.)

ining the minutes of that meeting, will you state as to whether you were present at the meeting.

A. I was present.

Q. Do you remember the circumstances of this second amendment, with reference to three more additional pictures having been brought before the Board?

A. That's the one dated July 21, 1950, if I remember correctly?

Q. Yes.

A. Yes. I remember that the Board was told that it was proposed to amend the United States Pictures agreement further by providing for additional pictures and for the extension of time for delivery.

Q. Do you remember that it was also pointed out that as to these additional pictures, Warner Bros. would finance the making of each of the pictures, and that it would receive a domestic distribution rate of twenty-five per cent, and British and other foreign of thirty per cent, and various other rates, and that after recoupment of the distribution charge and the entire cost to Warner Bros., that the profits would be divided *eight* per cent to Warner Bros. [784-163] and twenty per cent to United States Pictures?

A. That's my recollection.

Q. Do you also remember that it provided for a rate of overhead as to Warner's facilities that was higher than that provided by the basic agreement?

A. That is my recollection.

(Deposition of Robert W. Perkins.)

Q. You understood that at the time you voted on the amendment? A. Yes, sir.

Q. Did anybody suggest or direct how you should vote on that matter? A. No.

Q. Was your vote the result of your own independent judgment? A. Yes.

Q. You regarded the amendment to the contract as being for the benefit of Warner Bros.?

A. Yes.

Q. You voted in favor of that amendment, then, I take it? A. Yes.

Mr. Williams: I have no further questions.

* * * * * [784-164]

Cross Examination

Q. (By Mr. Pottish): Mr. Perkins, is it your understanding that the three Warner brothers could, if they wished, caused a termination of your position as general counsel to the company?

A. Only if I acquiesced in their decision, Mr. Pottish. I—each year I have been elected general counsel by the directors, and I would not think that the three Warner brothers could terminate that relationship without the approval of a majority of the directors.

On the other hand, if your question is meant to cover the further question as to whether I would remain as general counsel over the opposition of the three Warner brothers, that is a different matter.

Q. Would you, Mr. Perkins?

(Deposition of Robert W. Perkins.)

A. Remain as general counsel?

Q. Yes. A. No.

Q. And would you remain as a director for the ensuing year over the opposition of the three Warner brothers?

A. I couldn't answer that question without knowing the circumstances under which it arose, Mr. Pottish. After all——

Q. Do you feel they have enough influence by themselves [784-165] with the Board, at the next election of the Board, if they so wished, to keep you off the Board of Directors?

A. Well, I'm elected, of course, by the stockholders for a term of two years. Our terms run two years. And I'm nominated by the Board of Directors to be a director. Unquestionably, the Warners have considerable influence with the Board.

The former question was directed to the problem as to whether I would remain as a director if asked by the Warners, and I told you frankly that I would have to know the circumstances, because I hold office as a director under mandate from the stockholders.

Q. My point is, Mr. Perkins: If at the end of your term the three Warner brothers desired to see to it that you were not nominated for the ensuing term, do you think that they could succeed in keeping you off the slate going before the stockholders?

A. I don't know. I don't know. Whether I would be a candidate is an entirely different question.

(Deposition of Robert W. Perkins.)

Q. Would you be a candidate against their wishes? A. I don't think I would.

* * * * * [784-166]

Q. At that time, were you familiar with the facts as to whether or not Warner Bros. Pictures had ever made a similar contract with any other independent producer prior to that date?

A. Oh, I'm sure that we had made contracts with independent producers prior to that date, and subsequent to that date; and I'm sure that we've made contracts of the same general type.

Q. I am afraid I did not get my question clear. I understand that other contracts have been made by Warner Bros. with other independent producers, both [784-169] before and after that contract of September 28, 1945, but my question is: Did you know at that time, September 28, 1945, whether with regard particularly to United States Pictures, the United States Pictures contract and the particular terms in that contract regarding such things as financing or recouping of losses and the method of financing and the share of profits, the Warner Bros. had ever made a similar contract with another independent producer which was as favorable or more favorable to the independent producer?

A. I certainly believed at that date that the contract which had been negotiated with United States Pictures was in general the same as contracts which have been negotiated with other independent producers. * * * * * [784-170]

Q. Did you at or prior to the meeting of Sep-

(Deposition of Robert W. Perkins.)

tember 28th, make an independent investigation as to whether or not the provisions of the United States Pictures contract was or was not more favorable to the independent producer than the provisions of other contracts with other independent producers?

A. No; not an investigation in the sense of looking up records and talking to people.

Q. Did Major Warner at that meeting of September 28, 1945, state that it was the recommendation of both his brothers on the Coast and himself that the contract was a good one for the company?

A. Yes. * * * * * [784-172].

Q. With regard to that amendment, presented to the Board on August 17, 1950, by whom was that amendment presented to the Board?

A. That I don't remember. [784-174]

Q. That amendment to the basic contract: Had you seen that amendment prior to the meeting of the Board itself?

A. I don't remember.

Q. Do you remember whether or not, prior to voting on the approval of that amendment, you had made an independent investigation of whether or not the amendment was a good one or a fair one to the company?

A. No. I didn't make an independent investigation.

Q. Is it fair to say that with regard to your voting on that amendment, you relied upon the judgment and recommendation of those people who

(Deposition of Harry M. Warner.)

Q. Would that be before the corporation, United States pictures, Inc., was incorporated?

A. Oh, yes, quite a time before.

Q. And would that be a number of months before or longer?

A. Oh, I think it was quite a time. If I was asked to the best of my recollection, I would say it was not less than eight months; maybe longer than that.

Q. Now, did you have any discussions then with Mr. Sperling as to how you would work out your plans for him?

A. I had no discussions with Mr. Sperling about how he was to work for us or what he was to do until I was assured that 20th Century-Fox would let him go. [784-225]

Q. I see.

A. Because I understand there was quite a battle there; that is, I was told that they didn't want him to go.

Q. After Mr. Skouras gave the release, then did you discuss with Mr. Sperling what the arrangements would be between him and Warner Brothers?

A. We discussed from time to time how we could go ahead and get something together that could bring him in with this company, with the understanding that if some misfortune should happen, that he would be able to take over my brother's place, relieve me of that responsibility.

Q. Were those discussions between Mr. Sperling

(Deposition of Harry M. Warner.)

and yourself alone, or were others present when they took place?

A. Oh, I couldn't tell you. There were quite a number of discussions pertaining to a business deal.

Q. And that would be discussions over a period of several months?

A. I would imagine, as I recall.

Q. Now, during those discussions, was it discussed whether he would come in on a salary or as an independent producer?

A. Well, now, that was in my own mind in order to develop a man to have—to occupy the position that I would want him to occupy here, take the place of my brother. I felt that he ought to get a good experience, a business experience, without just writing stories or making pictures. [784-226] The motion picture business is no different than any other business; you have to have business experience in addition to the knowledge of making a picture; and then when I found that I could get him loose, I set about to see how I could get a good business man to hook up with him and get him an experience that a man in that kind of a position would require, and I got him Joe Bernhard. Now, Joe Bernhard was the man that I brought into this business from the real estate business and taught him how to operate our theatre business. And in particular, in those days, he needed a lot of teaching, because business was bad, plenty of debts—I don't know how much—a hundred and fifty, sixty or

(Deposition of Jack L. Warner.)

A. Yes, virtually.

Q. Your major production is here in this studio in Burbank? A. Yes.

Q. Beginning in about 1945, what proportion of your production has been in this studio?

A. I believe all at that time. Yes, it was; all of it was here then.

Q. When did you start production in places other than the Burbank Studio?

A. It has only been just three or four pictures in England, the last couple of years.

Q. Will you explain in a little more detail what the nature of your duties is, being in charge of production?

A. I purchase, pass on the purchasing of, stories and plays and novels. I engage the producers, the important [784-179] stars, artists, the top artists, the top directors, do the reading of the scripts, for the preparing of them for the final production, and then, in cooperation with the producer and director, supervise the editing of the films, up to their final readiness for exhibition. Or I turn it over to our laboratory. That is the best way to put it.

Q. Do you perform those duties in regard to all of the films that are produced here in the Burbank studio?

A. All the pictures produced by our corporation, yes.

Q. Does that include the pictures produced under contracts with independent producers?

A. With some I do, and some I don't. Some of

(Deposition of Jack L. Warner.)

the time, myself and others. I help everybody, in one form or another, whether I have the autonomy or not.

Q. How do you determine the extent of your help in connection with independent producers?

A. I haven't any yardstick. Just questions asked; and I go to their previews and help them on what they call editing the picture. You know, removing scenes or adding or retaking scenes, or if photography should be bad, I suggest that they remake some scenes. When they have their own autonomy, of course, it is not mandatory on their part. It is just voluntary, free advice I give them.

Q. Which independent producers have their own autonomy? A. You mean now? [784-180]

Q. Now, that are producing now.

A. Right now there is William Cagney Productions, Norma Productions, which make pictures with Burt Lancaster, Alfred Hitchcock, and the United States Pictures. That is the four that are producing, I believe. I think that is all right now.

Q. In those the help is voluntary on your part; is that correct?

A. Yes, sort of. They take advantage of my experience, gratis.

Q. You spoke of United States Pictures; that is the company in which Milton Sperling is president?

A. I believe he is president, yes.

Q. When did you first know Milton Sperling?

A. I have known Milton Sperling for over 20 years. He worked here at this studio, and then he

(Deposition of Jack L. Warner.)

left, and the next—I watched his career, especially at 20th Century-Fox, where he produced quite a number of very important pictures, all with very top stars, and I imagine very successfully.

Q. Do you know what pictures he produced at 20th Century-Fox?

A. Offhand, To the Shores of Tripoli, a big technicolor picture, which was a fabulous success; Hello, Frisco, Hello, with Betty Grable, which I am pretty sure was a hit; [784-181] and there was one I saw with Tyrone Power—I forget who the rest of the cast was—called Crash Dive, a submarine picture.

I think all of them were in color, and they are pretty vivid in my mind.

Several others; I could tell you, if I could just look at a memo I made on just exactly what the pictures were.

Q. Will you do that?

A. Yes. One called Hot Spot, with Betty Grable; Rings on My Fingers. I forget who was in that now. Another one was with Sonia Heinie, called Sun Valley Serenade, a big hit. Those are the six top pictures. He may have made more, but I don't remember them. I do remember these top pictures.

Q. You have been referring to a memo; did you just make that recently?

A. No, I have been jotting this down for a long time, off and on.

Q. Over what period of time?

A. Two or three or four years, off and on. In

(Deposition of Jack L. Warner.)

fact, I found this little memo somewhere among some papers, a couple of days ago, going through the drawer. I may have made this at the time we were going to engage him, make the [784-182] deal with him.

Q. I was going to ask you, was that made at that time or was it made subsequent to that time?

A. I wouldn't want to say it was made since or before. I made it for one reason, just to bring fresh to my mind the pictures he had produced, and credit for such. That is all there is to it. It isn't any usual memo, just a small piece of paper.

Q. When did you first know that Warner Bros. was considering entering into a contract with Milton Sperling, for him to act, either individually or through a corporation, as an independent producer?

A. The first I heard of it was, as I say, around in 1945. I can't remember the exact dates, but my brother told me about it. Milton had come back from being in the Marines at the time, and he said he was going to go back to Fox, or some company he was going back with, and would we be interested? I said yes, if we could make the proper deal for the corporation, we would be happy to make the deal with him, because we were looking for manpower. I, too, had just returned from the Air Forces. I had been to Europe, came back fresh in mind, and held a big meeting with all our producers, directors and executives, and told them we have to get manpower to make pictures.

I could see ahead that there was going to be hard

(Deposition of Jack L. Warner.)

[784-183] sledding to get the right manpower to produce pictures, and everything I predicted then has been true, right up to this very day. It is very hard to get the right people to produce pictures.

Q. When you had that conversation with your brother, was that before the corporation United States Pictures was formed?

A. I don't know. I wouldn't know.

Q. It was before the contract was signed between United States Pictures and Warner Bros.?

A. It must have been, because my brother talked to me about it.

Q. Were you in New York at the time the board of directors approved the contract between Warner Bros. and United States Pictures?

A. I believe not, although I am not sure. I feel certain that I wasn't, but I am not positive. The record would have to show that.

Q. What I am trying to do is find out if you place the time in your mind, about when that contract was signed or approved.

A. All I know is, around six years ago, in 1945, or something like that. I couldn't tell you the exact time.

Q. Would you know about how long before it was signed, if it was before it was signed, that you discussed [784-184] with your brother the propriety of entering into such contract?

A. No, I don't know. The time would be hard to place, at this late date. All I know is that we

(Deposition of Jack L. Warner.)

made the deal with the man for a good purpose, for the corporation.

Q. Is it true that most of the contracts with independent producers are originally instituted, or instigated, by you?

A. There isn't any set pattern. My brother may have talked to some of these independent men, or I may have. I would be the one who would conclude the deals, yes, but who started the deals I couldn't tell you. We made many independent producing deals.

Q. Did you conclude the deal with Milton Sperling and his corporation, in this instance?

A. No, I didn't. When I say "conclude," I mean I stated it would be a very good thing to have any good independent production company here who could make profits for the company, or attempt to make profits, because you don't always make profits in making pictures, you know.

Q. Who worked out the terms of the agreement between Warner Bros. and United States Pictures, if you know?

A. I don't know who worked with that, I really don't.

Q. Did you go over the terms of the agreement, at any time prior to the time it was signed?

A. Yes, I went over the terms of that contract, the same as I do with every other contract.

Q. Would you say that you concluded that contract as you did the other contracts with independent producers?

(Deposition of Jack L. Warner.)

A. I would say that I was equally responsible in concluding that, as well as any other one, yes.

Q. With whom did you discuss the terms of the proposed contract?

A. I talked with our attorneys; whether in the presence of my brother or not I just can't remember. Probably he was there; I don't know.

Q. Did you discuss it with Milton Sperling?

A. No doubt I did, yes; I am sure I did.

Q. Do you remember discussing it with Milton Sperling now?

A. No doubt I did. I can't remember exactly, but I would say I did.

Q. Did you discuss with him the proportion of the cost that would be borne by each of the companies?

A. Whatever the contract states, I discussed. Terms and conditions of the contract—as you no doubt have a copy of it—tells the story that I discussed. * * * * * [784-186]

DEPOSITION OF HARRY M. WARNER

Plaintiff's Exhibit No. 122: Deposition of Harry M. Warner, a defendant in the above entitled action, taken on behalf of the plaintiff, on Wednesday, November 8, 1950, at 2:00 p.m., at 4000 West Olive Avenue, Burbank, California, before John B. Hossack, a Notary Public within and for the County of Los Angeles and State of California, pursuant to the anexed stipulation. * * * * *

Harry M. Warner, having been first duly sworn, deposed and testified as follows:

Direct Examination

* * * * * [784-210]

Q. (By Mr. Lyon): Now, will you state your position with the Warner Bros. Pictures, Inc.?

A. I am president.

Q. How long have you been president?

A. Since its inception; '23, I think it was, 1923.

Q. Are you also a director? A. Yes, sir.

Q. How long have you been a director?

A. For the same time.

Q. Are you also a stockholder?

A. Yes, sir.

Q. How much stock do you hold?

A. Personally?

Q. Yes. A. At this time?

Q. Yes.

A. Oh, maybe 350 or 400,000 shares. I don't now exactly what.

(Deposition of Harry M. Warner.)

Q. Now, in September of 1945, did you hold approximately the same number of shares?

A. I would say as much or more. I don't remember exactly.

Q. And you have held approximately that number of shares since August and September of 1945?

A. Well, I would have to recall when we doubled up the shares. I am speaking numerically.

Q. Yes.

A. We doubled the stock of the company and gave a share for each share held.

Q. In other words, at some time you issued two shares for each share held by the stockholders?

A. I believe so. [784-212]

Mr. Freston: May I answer that?

Mr. Lyon: Yes.

Mr. Freston: There was a stock split up some time ago, and that simply increased the number of shares outstanding without changing the relative value of the shares as a whole.

Q. (By Mr. Lyon): Then, Mr. Warner, your proportionate number of shares has remained approximately the same since 1945?

A. Yes, sir.

Q. Where do you maintain your offices as president of Warner Bros.?

A. Here; New York.

Q. Approximately what part of your time is spent here and what part in New York?

A. Well, that I can't tell you at this moment. It

(Deposition of Harry M. Warner.)

used to be at one time more in New York than here, and of late it is more here.

Q. When did that change take place?

A. When the troubles in business come in, why, my spot changes.

Q. And since 1945 has the amount of time that you spend here increased or decreased?

A. Well, it is about the same; it has been since about '36 or '37.

Q. Would you say that you had divided your time [784-213] rather equally between your New York and Burbank office?

A. Well, I would just be guessing. It all depends where it is required, mostly.

Q. What are the general nature of your duties as president?

A. To guide this company, to make money, to be successful.

Q. Do you do any of the guiding in connection with the production of pictures?

A. It depends on what part; as to the cost of pictures, yes, and discuss what to make. We have to do that possibly a year or two in advance. You can't start and decide you are going to make a picture and turn it out the next week, put it out. It takes sometimes two or three years.

Q. Do you supervise or discuss the making of contracts to produce pictures?

A. Yes, sir.

Q. And——

(Deposition of Harry M. Warner.)

A. (Interrupting): Did you get that answer, sir?

Q. Yes.

A. Yes. Some; now, I won't say all. Now, wait a minute. I discuss contracts for the purpose of making pictures, but I wouldn't say that I discuss all. There may be a picture made here or there that I don't.

Q. I see, but if you could state a general rule, [784-214] you generally supervise the making of the contracts that result in the production of pictures?

A. The principle, yes; the principles of it.

Q. How long have you been in the motion picture business? A. 45 years.

* * * * * [784-215]

Q. (By Mr. Lyon): Now, are you generally familiar with the date that United States Pictures, Inc., was incorporated?

A. No, I don't know.

Q. Would it refresh your recollection, that it was incorporated in August of 1945?

A. If you would say so, I would take it for granted.

Mr. Lyon: Is that correct, Mr. Schwab?

Mr. Schwab: Well, I don't have the exact date here, Mr. Lyon. We furnished it to you in the interrogatories.

Mr. Lyon: Yes, that was the date in the interrogatories.

Mr. Schwab: Well, then, that is correct.

Mr. Lyon: All right.

(Deposition of Harry M. Warner.)

Q. Now, prior to August of 1945 or prior to the formation of United States Pictures, Inc., did you discuss with Mr. Sperling the prospective formation of a corporation to produce pictures?

A. Well, I didn't discuss so much with him any formations of any corporation except that I discussed with him about coming with this company.

Q. When did that discussion take place?

A. I would say about when he came back from the [784-221] Marines, when he was discharged, after his discharge from the Marines.

Q. Where did that discussion take place?

A. Well, that I couldn't tell you, but I could tell you what caused it.

Q. Will you do that?

A. If you would like to know what caused it, I haven't any objection in telling you. There was a doctor by the name of Sam Hirshfeld, since deceased, who was my personal doctor and my brother Jack's. He came in to this room one day and said: "Well, we just carried your brother out of here," and he says, "Now, I would advise you to do something about it, because he is a pretty sick man. We have been carrying him out of here quite a few times. He is overworked, and what the ultimate result may be, we don't know." So, it was then that it occurred to me that I had better start in finding someone in whom I had enough confidence that I would want to develop into a position of my brother to operate this studio; because I certainly couldn't do it. It was then that I looked around

(Deposition of Harry M. Warner.)

and thought, "This young man has ability, and I would prefer him—I would have more confidence in him than in any one else in that position."

Q. What did you do to satisfy yourself that he did have the competency to take over that position?

A. What did I do?

Q. Yes.

A. I went about trying to get him.

Q. What did you do to make the determination that he was of that competency?

A. My own judgment.

Q. What had you seen him do that made you form that judgment?

A. Well, I have passed judgment on many a man without seeing him do anything. I have passed judgment on a man's ability by the things that he had done.

Q. What had he done that you took into consideration?

A. Well, I would have to get you an analysis of it.

Q. Was it based upon work that he had done in motion pictures?

A. In motion pictures, yes, sir. I don't know anything about him outside of in motion pictures and his career with the Marines. That is about all that I know.

Q. Was that work that he had done in motion pictures for Warner Brothers or work that he had done in motion pictures for 20th Century-Fox?

A. 20th Century-Fox mostly.

(Deposition of Harry M. Warner.)

Q. How did you familiarize yourself with what he had done for 20th Century-Fox?

A. I know the business pretty well. When somebody [784-223] has ability, I am able to judge. I have so far done pretty well in my judging.

Q. Did you judge by viewing the pictures with which he was connected, or—— A. Yes.

Q. (Continuing) ——by talking to Mr. Sperling, or how?

A. Talking to Mr. Sperling, viewing the pictures, talking to others, talking to Mr. Skouras. There are three Skouras'; so, let's not get mixed up with the three. This is Spiros Skouras I am talking about, the president of 20th Century-Fox.

Q. Did you determine——

A. (Interrupting) Pardon me. I explained to Mr. Skouras my problem, and there was no use my going any further and thinking about it unless I could get him freed from 20th Century-Fox, with whom he had a contract and who was trying to get him to sign a new contract for a number of years.

Q. Did you ascertain at that time what remuneration he was receiving from 20th Century-Fox?

A. Yes, I did; yes. As I recall, I think he was getting $1,250 a week, and they were trying to get a new contract with him for twice that much.

* * * * * [784-224]

Q. Now, when did you first discuss with Mr. Sperling your plans for him?

A. At that time.

(Deposition of Harry M. Warner.)

eighty million. You had to meet the payrolls, you know, and the expenses.

Q. Yes.

A. So that I had trained Mr. Bernhard, until one day I said, "You go ahead from here on and run that end of the business." I thought that the combination of Sperling as a producer and Bernhard as a business man would be a good combination to learn what this was all about.

Q. Yes.

A. You could have the best producing man in the world right here to make pictures, but you need a little more than that.

Q. Now, did you discuss with Mr. Bernhard the [784-227] possibility that he would join forces with Mr. Sperling to have this independent producing company? A. Yes, sir.

Q. Did you discuss that with Mr. Bernhard prior to the actual formation of the corporation, United States Pictures?

A. Yes, sir; because Mr. Bernhard, you must remember, had a pretty good job with us. I think he was drawing $3,000 a week, and bonus; and when you ask a man to give up a position of $3,000 a week and a pretty good bonus, why, you naturally discuss it with him. Now, the thing that I was interested in was that I myself wasn't so well. You see, I had been in the hospital a few times myself and I wasn't as healthy as I was, and I was looking to create a combination to take the place of even myself.

(Deposition of Harry M. Warner.)

Q. Did you discuss this with Mr. Bernhard over perhaps a period of six months prior to the actual formation of the corporation, too?

A. I don't remember how long, but we started in slowly and developed the talks.

Q. Were those talks generally between the three of you; that is, yourself, Mr. Bernhard and Mr. Sperling?

A. No; I discussed this thing with each one at first separate, because it was the only way I could do it.

Q. Yes. [784-228]

A. And then I brought them together to see if the two could work together. That was the big problem.

Q. Then as you discussed it with them, either separately or together, did you discuss whether it would be an independent producing venture rather than their acting as employees of Warner Brothers?

A. I discussed with them that they should start in the best way that they could get the most education in the operating and the operation of a business of that type; because you must bear in mind that Mr. Bernhard was not familiar with the production end.

Q. Did you discuss with them the formation of a corporation to carry on their production rather than the lack of corporation?

A. As I recall now, I don't think I had anything to do with that, how the corporation was to

(Deposition of Harry M. Warner.)

be formed or what the name was to be. I may have heard it, but I don't think I played any part in that; not that I remember.

Q. Did you discuss with them what percentage of the net profits of the pictures the independent producing venture would receive as opposed to the percentage that Warner Brothers would receive?

A. I laid out the formula that the company, if the two could get together, that—I laid out the formula that [784-229] the company should operate under, and took it up with my brother, and we agreed upon that plan.

Q. And that was basically the formula that was eventually incorporated into the written agreement?

A. No, wait a minute. I merely laid out the plan. I turned it over to Mr. Freston here, as the attorney, and told him to write up a deal—I first explained to him why I wanted it done, and then I told him to write up what was fair to the company, and he did it. I don't think I ever saw it after that. He explained it to me, and when I was sure that he had satisfied himself it was a deal that was fair for all parties concerned, why, that was the end of it, so far as I was concerned.

Q. Did you discuss with them prior to the actual drafting of the contract how the Warner Brothers' overhead would be figured?

A. Yes. I think when it came around to that, I asked our New York people what our overhead was, because I didn't believe that in order to form a company with men of that type and for the pur-

(Deposition of Harry M. Warner.)

pose that you want to use them, you should make money except through their efforts—not on them, but through them—and if I recall, I was told what our overhead was for distribution, and I did that with Mr. Kalmenson. He is our general sales manager. I increased the amount from what it cost. I can't recall as to whether [784-230] they told me it was—it seems to me that they told me at that time it was 14 per cent for distribution in this country.

Mr. Freston: Pardon me for interrupting a minute. I think you are getting away from counsel's question. He asked you about overhead and not about distribution costs.

The Witness: Oh, overhead?

Mr. Freston: Overhead.

The Witness: I consider that overhead; that is overhead, too.

Mr. Freston: He means overhead for use in the facilities of the studio.

The Witness: For the studio, I think I asked Price, Waterhouse to set that up. If I recall right, I think I asked Price, Waterhouse, who are our accountants, to set up what would be a fair deal. That is the way I recall it.

* * * * * [784-231]

Mr. Levy: I offer Exhibits 85-A and 85-B, 85-A being an employment contract between United States Pictures and Charles Yoss; 85-B being an employment contract between United States Pictures and Donald Hyde.

Mr Williams: To which we object on the grounds

they are incompetent, irrelevant, and immaterial, not tending to prove or disprove the issue now before this court; on the further ground both of them are hearsay. [822]

The Court: What is the purpose of this offer?

Mr. Levy: The purpose of these contracts is to show the course of dealing between Warner and United.

The Court: For that purpose the objection is overruled.

Mr. Williams: Warner was not a party to these contracts. The contracts could not possibly show that.

Mr. Levy: Notwithstanding that, Warner was, by the terms of this contract, affected by the entry into these contracts which are offered in evidence.

The Court: I have ruled in favor of their admissibility.

Mr. Levy: I am sorry, sir.

The Court: Exhibits 85-A and -B are received in evidence. [823]

* * * * *

The Court: Your next offer.

Mr. Levy: Exhibit No. 97-A-1 and A-2.

The Court: Two contracts with John Flynn apparently.

Mr. Levy: Yes, your Honor.

Mr. Williams: These are contracts with actors and actresses.

Mr. Levy: Yes, the contracts with John Flynn I will offer.

The Court: Are they here?

Mr. Schwab: No. I have them, your Honor.

The Court: Is there objection to the offer?

Mr. Williams: Yes, we will object to them upon the grounds they have no tendency to prove this issue involved now before this court and they are irrelevant and immaterial. [842]

* * * * *

The Court: Very well. The objection is overruled. Exhibits 97-A-1 and 97-A-2, the Flynn contracts, will be received in evidence. [843]

* * * * *

The Court: Do you have other witnesses you expect to call on these issues as to jurisdiction and limitations other than Mr. Obringer? Can you give me some estimate of when you will be able to rest on that issue? [848]

* * * * *

The Court: Do you expect to offer that in evidence? Do you wish me to read that this evening?

Mr. Levy: The Bernhard deposition?

The Court: Yes.

Mr. Levy: Mr. Williams made a condition to the offer. In other words, he attached to his stipulation a condition that I will not call Mr. Bernhard, and I asked your Honor——

The Court: On these two issues.

Mr. Williams: On these two issues, yes, your Honor.

Mr. Levy: On these two issues. And I asked your Honor to permit me to defer my decision on that until I shall have had the opportunity to read

again through these Bernhard depositions, until tomorrow.

The Court: Very well. I expect to read Exhibit 122 in evidence, the deposition of Harry M. Warner, to complete that this evening, and if it would save time I would read Exhibits 123-A, B, C and D.

Mr. Levy: Yes, if Mr. Williams had not made the condition, I would be perfectly satisfied to do that.

The Court: Perhaps you could ameliorate the situation [854] by stating whether or not, so far as you are advised, you have any intention of calling Mr. Bernhard on the trial of these two issues.

Mr. Levy: At the present time I have no such thought of calling him.

The Court: On counsel's statement, can you eradicate the condition or remove the condition from the stipulation that Rule 26(d)(2) and (f) will apply to the Bernhard deposition, so the witness Bernhard will be considered an adverse party within the meaning of the rule?

Mr. Williams: Yes, your Honor, I will do that. I may say that, as a practical matter, I have no doubt that the court will so regard him anyway.

* * * * * [855]

(Plaintiff's Exhibit 123-A, -B, -C and -D for identification was received in evidence.) [856]

* * * * *

The Court: This agreement of October 31, 1945, between United and Warner and the New York Trust Company is in evidence here as exhibit what?

Mr. Levy: That is in evidence here, your Honor, as Exhibit 8. [860]

* * * * *

DEPOSITION OF JOSEPH BERNHARD

Plaintiff's Exhibit 123-A: Deposition of Joseph Bernhard, a witness in the above-entitled action, taken on behalf of plaintiff Edward S. Birn, at 2:00 p.m. on Thursday, May 8, 1952, at 735 Van Nuys Building, 210 West 7th Street, Los Angeles, California, before Frank Hanna, a Notary Public within and for the County of Los Angeles and State of California, pursuant to notice annexed.

* * * * *

Direct Examination

* * * * * [862]

Q. (By Mr. Levy): Mr. Bernhard, you were a director of Warner Brothers prior to September 10, 1945? A. Yes.

Q. Were you also an employee of Warner Bros. prior to that time? A. Yes.

Q. Were the terms and conditions of your employment reduced into writing?

A. Yes. [862-3]

* * * * *

Q. What was your weekly salary before you quit Warner Bros.?

A. Well, with expenses, it was $3000 a week.

* * * * * [862-5]

Q. What department in Warner Bros. did you head? A. Theatre.

(Deposition of Joseph Bernhard.)

Q. Just what does that mean? Will you give us a brief description of your duties?

A. Well, general manager of approximately 480 theatres—operating theatres. [862-6]

* * * * *

Q. Mr. Bernhard, in a deposition of Mr. Harry Warner taken on November 8, 1950, Mr. Warner stated that he got you for Mr. Sperling—meaning that he arranged for the association between you and Milton Sperling in U. S. Pictures. Is that so?

Mr. Williams: Just a moment. I object to that as calling for a conclusion and speculation and opinion on the part of the witness, and an improper comment on the testimony of another witness, leading and suggestive; and incompetent, irrelevant and immaterial, for the reasons stated.

Q. (By Mr. Levy): Will you answer the question? A. Repeat it, please?

Mr. Williams: The question also calls for a conclusion as to what Harry Warner meant by certain language he is purported to have used.

Q. (By Mr. Levy): Let me put it this way: Did Mr. Harry Warner approach you to associate yourself in business with his son-in-law, Mr. Sperling? A. Yes. [862-10]

* * * * *

Q. When Harry Warner first approached you on the proposition, just briefly what was the conversation between you? [862-11]

A. That he thought it would be a very good plan for Milton and I to get together. Milton knew one

(Deposition of Joseph Bernhard.)

end of the business and I knew the other, and we could produce some pictures to release through Warner Bros. It appealed to me, because in those days —as it is today—no matter if you got a high salary, you could not retain much of it. So I saw the opportunity of probably building up an estate for myself. Therefore it appealed to me. You see I knew all the exhibitors throughout the country; I knew distribution; and my work in that end would prove very advantageous. [862-12]

* * * * *

Q. It was not at the first conference that you told Mr. Warner that you were satisfied, was it?

A. No. The first few conferences were more or less gossiping conversations.

Q. The proposition was made to you, Mr. Bernhard, and you took time out to consider it? Is that what you mean?

A. I took a great deal of time to consider it.

Q. I assume you called on Mr. Warner again, and talked to him about it?

A. Oh, yes. You see, the visits were far apart; because he was out here and I was in New York.

Q. At that time?

A. Yes. We talked every time we met, whether it was in New York or California. [862-13]

* * * * *

Q. Well, as a matter of fact, your first conversation with Mr. Sperling amounted to practically this: If we get a deal that is satisfactory to the two

(Deposition of Joseph Bernhard.)

of us from Warners, we will become 50-50 partners; is that what you mean?

A. Correct.

Q. That is all there was to that conversation; is that right? A. That is right.

Q. What did you do after that? Did you go to see Mr. Warner?

A. Then we approached Mr. Warner.

Q. Both of you? A. That is right.

Q. And?

A. And we eventually made the deal. [862-17]

Q. I am not talking about eventually. I know you eventually made the deal. But I am trying to get to the negotiations that you had with Mr. Warner, before the deal was outlined finally. Or did you have any negotiations with Mr. Warner?

A. Yes, certainly.

Q. What was the bargaining, if there was any?

A. Well, I don't recall the bargaining. I tried to make a fair deal for both sides.

Q. Did you tell Mr. Warner what you thought a fair deal would be?

A. I suggested a certain deal.

Q. What deal did you suggest?

A. Well, there were modifications eventually made in it, for example, if we were to produce pictures on the lot and I had a discussion on the overhead that they would charge; and we agreed on the overhead, eventually. I thought it was rather high. Now, this is from the United Pictures end. I thought the overhead was very high; because if we

(Deposition of Joseph Bernhard.)

went out and produced our pictures on the outside, I could have benefitted that overhead—or lowered that overhead to—well, probably 20 per cent.

Q. You knew that at the time? A. Yes.

Q. Had you had any experience with the production [862-18] department at all with Warner Bros.?

A. I knew all the bookkeeping phases.

Q. Do you know what Warners' overhead was at that particular time, in 1945, the actual overhead cost?

A. Yes. At that time it was rather high for an independent producer.

Q. Do you know in terms of percentages what the actual overhead of Warners was at the time?

A. Yes; it was over 30 per cent.

Q. Over 30 per cent?

A. Yes. So we finally settled—Do you want to know what we came to——

Q. Yes.

A. We finally settled that Price, Waterhouse would compute the proportion of the pictures to their overhead and we would be charged the proportion that Price, Waterhouse stated would be fair. I think that is even in the contract with Warner Bros.

Q. Yes, it is.

A. (Continuing) And we also discussed the distribution terms; and we finally settled on the terms that are in the agreement.

(Deposition of Joseph Bernhard.)

Q. Do you know what Warners' distribution cost at that time was—actual cost?

A. Yes; I think it was about 16 per cent, actual cost, if my memory serves me right. [862-19]

Q. Who suggested the 20 per cent distribution figure?

A. Well, it was finally compromised on 20 per cent; but that was good terms in those days; because I know——

Q. (Interposing): Good terms for whom?

A. For Warner Bros. Because I know that independent producers were releasing through United Artists for 20 per cent; and I know that Sam Goldwyn at that time was releasing for 17½ per cent. * * * * * [862-20]

Q. Well, specifically, were there any arrangements made between you and Warner with respect to your getting $78,000 as severence pay, prior to your resignation? A. Yes.

Q. When were those arrangements made?

A. At the time that I resigned.

Q. That was after you had agreed in principle on your association with Mr. Sperling in U.S. Pictures?

A. That is right; because I still had to spend quite a bit of time with the Theatre Department and my successor to—if I may use the term—break him in.

Q. How long did you break him in?

A. Oh, I don't know. I practically commuted back and forth from here to New York; but while

(Deposition of Joseph Bernhard.)

in New York I spent all my time in the theatre department; because there were quite a few things that I, personally, had to attend to, for the theatre department. [862-21]

Q. In consideration of that you got $78,000; am I to understand that?

A. There was no consideration; it was just severance pay. I thought that, after being with the company for near onto twenty years, I was entitled to the severance pay.

Q. And you made that a condition to your resigning; is that right?

A. Well, I will not say it was a condition, no.

Q. Well, was it an offer made to you by Warner?

A. No. It was a suggestion made by me and acted on by the Board—not Mr. Warner.

Q. When you suggested it to Mr. Warner, what was his response?

A. That we will put it up to the board. Because the board acted on it, I remember that.

* * * * * [862-22]

Q. In negotiating the deal with Mr. Harry Warner, before the contract was drafted, was it understood that you were not to risk any capital and that Mr. Sperling was not to risk any capital, beyond the original investment of $25,000?

A. No, there was no understanding on that. I was supposed to obtain the first money for each picture — the bank money — not Warners; but I was to.

(Deposition of Joseph Bernhard.)

Q. You were to function, then, in obtaining a loan [862-24] from a bank, to begin the production of these pictures? Is that what you mean?

A. That is right.

Q. Was it then understood that you would not invest any of your own money beyond this $25,000?

A. There was never any discussion on it, that I can remember.

Q. In other words, it was assumed by both parties that Warners would advance half of the cost of each production, and that you would provide the other half, through banking connections?

A. That is right.

Q. And you did? A. I did.

Q. What was your total investment in this whole deal with United States Pictures?

A. Outside of my time—which, if I had been with Warners, would have been paid for——

Q. I am not talking about your time; but what was the total financial investment that you made?

A. I think it was $25,000.

Q. You invested $25,000 cash?

A. No.

Q. What was your total investment?

A. Twelve five. [862-25]

Q. Beyond that you did not invest any money; is that right? A. That is right.

Q. How much did you come out with at the end?

A. Gross, $400,000. * * * * * [862-26]

Q. I think I understand what you mean. What caused you to sell out, under those conditions?

(Deposition of Joseph Bernhard.)

A. Well, we will say a disagreement on policies.

Q. Can you give us an idea of what that disagreement was based on, or involved, briefly?

A. In policies of what we should do—kind of pictures.

Q. Well, what did you think you should do?

A. I thought we should make less expensive pictures.

Q. When you say less expensive pictures, you mean limiting the budget to approximately how much?

A. Oh, I would say about seven-fifty.

Q. And what was Mr. Sperling's idea?

A. Well, he wanted the higher priced pictures.

Q. By higher price, what do you mean?

A. Higher cost.

Q. Two million dollars or more?

A. No, I don't say that.

Q. A million and a half?

A. Yes. It was just a disagreement on policy.

Q. Was that the only disagreement between you?

A. That is all. * * * * * [862-31]

Q. What part did Mr. Prinzmetal play in this thing?

A. He represented Gary Cooper. Gary has no agent.

Q. Do you know that Mr. Prinzmetal received $25,000 in connection with the acquisition of Gary Cooper's services? A. That is right.

Q. Can you give us the detail of that deal, briefly?

(Deposition of Joseph Charles Yoss.)

A. Not necessarily.

Q. Or a picture produced or not necessarily produced?

A. Both or either, and I don't consider it production overhead when it is corporate expense.

Q. Such as what?

A. Say income taxes.

Q. Yes; what else? A. Interest.

Q. Yes? A. Franchise taxes.

Q. Yes? A. That is enough. [901-195]

* * * * *

Q. So that in general overhead are contained only such items as you specified a moment ago, namely, interest, income taxes and charges by the State of Delaware?

A. We charge to general overhead items those charges which are not proper charges to production overhead.

Q. Well, that is a generalization, Mr. Yoss. It would be better if we broke it down a little bit. Now, you have broken it down somewhat by telling us some of the items that you include in general overhead. Will you finish your job?

A. I gave you three items, and they constitute the bulk of our general overhead. There may be other items in there.

Q. Of what nature?

A. As I told you, anything that doesn't affect the production of a picture.

Q. Can you think of anything?

A. Not at the moment.

(Deposition of Joseph Bernhard.)

A. That is all it was. That was the condition.

Q. Tell me exactly what happened.

A. In order to get Gary Cooper, we paid a commission.

Q. You paid Mr. Prinzmetal a commission of $25,000? A. That is right. [862-36]

Q. As an agent's commission?

A. As attorney and agent.

Q. Did he ever perform legal services for you?

A. No. * * * * * [862-37]

Q. What part of this $25,000 was charged to Warner Bros.?

A. It all came under the cost of actors. This is off the record.

(Discussion off the record.)

* * * * * [862-38]

Q. May I assume that, had you passed up the suggestion, shall we say, of Mr. Warner, that you associate yourself with his son-in-law, that it would have had no effect on the renewal of your contract?

A. None whatsoever. I will say that emphatically. None whatsoever. * * * * * [862-41]

Q. Did you personally guarantee any of the U.S. obligations?

A. I don't recall. But morally I was in back of it; because my connection was the New York Trust Company. That was not Warner Bros.' connection. For your information, while we are on the subject of the New York Trust, I originally got the New York Trust many years ago—probably a year after

(Deposition of Joseph Bernhard.)

I was with the company—to loan Warner Bros. some money. That was during the dark days.

Q. You arranged for that loan?

A. I did.

Q. Through Mr. Bierwirth?

A. Through Mr. Bierwirth. I knew Mr. Bierwirth. Not until we got the loan did any of the Warners meet Mr. [862-53] Bierworth.

* * * * * [862-54]

Q. Did you have a residence here in California during that time? A. No.

Q. Did your residence ever change?

A. Never. I always voted in New York; still do.

* * * * * [862-79]

Q. Did you ever have any conversation with Mr. Jack Warner or Mr. Harry Warner prior to your splitting, as you call it, with Mr. Sperling, and in which you informed them, in substance, that you had a disagreement with Mr. Sperling, and that [862-105] you intended to split?

A. It was only to tell them that we intended to split on account of a disagreement in policy.

Q. With whom was that conversation had?

A. With Mr. Harry Warner.

Q. Do you recall what Mr. Harry Warner's response was? A. Sorry to see it happen.

Q. That is all?

A. That is the sum and substance of it.

Q. Mr. Harry Warner did not urge you to remain?

A. Mr. Harry Warner was very sorry, and

(Deposition of Joseph Bernhard.)

would like it if we could clear up the situation—yes, he wanted me to remain.

* * * * * [862-106]

Q. Did Mr. Harry Warner express any opinion as to who was right? A. No.

* * * * * [862-107]

Q. Where were the arrangements made for the sale of the stock? Were they made here in California or in New York?

A. In New York.

Q. In other words, your conversations with respect to the sale of the stock were had with Mr. Sperling in New York?

A. They were had with Mr. Sperling out here, and then back in New York with Stanleigh Friedman.

Q. At Mr. Friedman's office? A. Yes.

* * * * * [862-114]

Q. Is the Mr. Stanleigh Friedman that you refer to a director of Warner Bros.? A. Yes.

* * * * * [862-115]

Q. Did you or did you not resign as a director of Warner Bros. on the strength of having executed this agreement dated August 31, 1945?

A. The date of my resignation is a matter of record. I think that was brought out, was it not?

Q. I will tell you. The date of your resignation is September 10, 1945, ten days subsequent to the signing of this agreement. Now I ask you whether or not it was upon the strength of this agreement that you resigned as a director of Warner Bros.

(Deposition of Joseph Bernhard.)

Mr. Williams: You are speaking now of the agreement on the 31st of August?

Mr. Levy: That is right.

The Witness: Naturally.

Q. (By Mr. Levy): Prior to your resignation from Warner Bros. had you told Mr. Harry Warner or Mr. Jack Warner, or either or both of them, that you had entered into this agreement of August 31, 1945, with Mr. Sperling?

A. It was the reason for my resignation.

* * * * * [862-154]

DEPOSITION OF OLIVER B. SCHWAB

Plaintiff's Exhibit 124: Deposition of Oliver B. Schwab, a witness herein, taken on behalf of the plaintiff, at 10:00 o'clock a.m., Thursday, July 24, 1952, at 141 El Camino Drive, Beverly Hills, California, before Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, pursuant to Notice and Subpoena heretofore served on the attorneys for the defendants and subpoena duces tecum heretofore served on the witness. * * * * * [862-157]

Direct Examination

Q. (By Mr. Levy): What is your full name?

A. Oliver B. Schwab.

Q. You are the Secretary of the United States Pictures? A. That is correct. * * * * * [862-160]

Q. (By Mr. Levy): Did you participate in any

(Deposition of Oliver B. Schwab.)

of the negotiations between Milton Sperling and/or Joseph Bernhard with Harry and Jack Warner before September 28, 1945, which is the date of the first contract entered into between U.S. Pictures and Warner Bros.?

A. I would say that the negotiations of that agreement were carried on by Mr. Bernhard and Mr. Sperling and that I [862-165] was not a negotiator. * * * * *

Q. Well, let me preface the clarification by this question: Did you participate in the drawing of that contract?

A. Only to this extent: As I recall, the contract was drawn by Freston & Files and I looked at it before it was signed. As I recall, I had a discussion or two with Mr. Herbert Freston about it, as a result of which there may have been a few changes made in the contract and that was my relationship to the contract. * * * * * [862-166]

Mr. Levy: Your Honor, Exhibits 93-A and 93-B are minute books of the defendant United States Pictures. They are in two volumes. I do not see the necessity at this time of offering both volumes physically in evidence. I am particularly interested, however, in offering two pages, which are contained in Exhibit 93-A. May I offer those two pages in evidence?

The Court: Do they comprise the minutes of a certain meeting?

Mr. Levy: Yes, sir. * * * * *

Mr. Williams: I will object to it on behalf of

the Warner defendants on the ground there is no proper [884] foundation laid as to them. It is hearsay as to them. And, also, generally, I object to it on the same grounds stated with reference to Exhibit 39.

The Court: Wherein is the foundation lacking?

Mr. Williams: It is not being shown that Warner Bros. had anything to do with what transpired at the meeting or was present at the meeting. I don't raise any objection to foundation as to authenticity of the minutes, your Honor.

The Court: The objection is overruled. You may, if advised, read the excerpt into the record, in lieu of marking the physical exhibit into evidence, if there is no objection.

Mr. Williams: No objection to that.

Mr. Levy: "Minutes of a Special Meeting of the Board of Directors of United States Pictures.

"A special meeting of the Board of Directors of United States Pictures was held at 4000 West Olive Avenue, Burbank, California, on January 2, 1947, at 10:00 o'clock a.m., pursuant to waiver of notice signed by all of the directors of the corporation, which notice was ordered filed with the minutes of the meeting.

"There were present in person Messrs. Milton Sperling, J. C. Yoss, and Oliver B. Schwab, being all [885] of the directors.

"Mr. Sperling acted as chairman of the meeting and Mr. Schwab acted as secretary.

"Mr. Yoss made a motion, which was duly sec-

onded by Mr. Schwab, that the following resolution be passed:

"Resolved: That it is the opinion of this Board of Directors that Mr. Sperling in attending business, semi-business, and social functions in and about the motion picture industry, and in associating with and entertaining at the Hillcrest Country Club and in restaurants and in night clubs and in his home, producers, writers, directors, stars, agents, and other persons in and about the motion picture industry during the past year, and from this time forward, has incurred entertainment and other expenses which are for the benefit of and therefore have been incurred for and on behalf of the corporation;

"That it was the intention of the corporation in paying to Mr. Sperling the sum of $1000 per week during the year 1946 to have Mr. Sperling bear such ordinary and usual expenses for and on behalf of the corporation out of said sum of $1000 per week, and that accordingly said $1000 [886] per week represents compensation in part and in part an allowance for usual and ordinary business expenses incurred by Mr. Sperling for and on behalf of the corporation;

"That said $1000 per week was not intended, however, to cover any extraordinary or unusual expenses (such as, but not limited to, traveling expenses), and that this corporation shall reimburse Mr. Sperling for any and all unusual and extraordinary expenses heretofore or hereafter incurred by him for and on behalf of the corporation."

End of resolution.

"The motion was unanimously passed by the affirmative votes of Mr. Yoss and Mr. Schwab, Mr. Sperling refraining from voting.

"Thereupon Mr. Yoss made a motion, which was duly seconded by Mr. Schwab, that the following resolution be passed:

"Resolved: that commencing January 1, 1947, Mr. Sperling's salary from the corporation be raised from $1000 per week to $1250 per week;

"And further resolved: that it is in the best interests of this corporation that Mr. Sperling, as President of the Corporation and as producer of its pictures, attend all business, semi-business, [887] and social functions possible in and about the motion picture industry, associate with and entertain at the Hillcrest Country Club, at the Racquet Club, the restaurants and night clubs and at his home, producers, writers, directors, stars, agents and other persons in and about the motion picture industry;

"That the corporation disburse to Mr. Sperling, in addition to his salary as aforesaid, an expense allowance in the amount of $250 per week to cover all usual and ordinary entertainment and other expenses incurred by Mr. Sperling on behalf of and for the benefit of the corporation;

"And that if at any time hereafter Mr. Sperling incurs any extraordinary or unusual expenses for and/or on behalf of the corporation (such as, but not limited to, traveling expenses), the corporation shall, of course, further reimburse Mr. Sperling for such unusual and extraordinary expenses."

End of resolution.

"The resolutions were unanimously passed by the affirmative votes of Mr. Yoss and Mr. Schwab. Mr. Sperling refrained from voting.

"There being no further business to come before the meeting, on motion duly made, seconded, [888] and carried, the meeting is adjourned."

Signed: "Oliver Schwab, Secretary."

* * * * * [889]

The Court: The Yoss deposition, Exhibit 125-A, -B, -C, -D, -E will be incorporated by reference into the reporters' transcript at this point and may be copied therein if counsel so arrange with the reporter.

(The documents marked Plaintiff's Exhibits 125-A to -E, inclusive, were received in evidence.) * * * * * [900]

DEPOSITION OF JOSEPH CHARLES YOSS

Plaintiff's Exhibit No. 125A: Deposition of Joseph Charles Yoss, a witness produced on behalf of the plaintiff herein, taken on Tuesday, August 5, 1952, at 1:30 p.m., at 141 El Camino Drive, Beverly Hills, California, before Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, pursuant to oral stipulation. * * * * * [901]

Direct Examination

Q. (By Mr. Levy): What is your full name, sir? A. Joseph Charles Yoss.

Q. Where do you reside?

(Deposition of Joseph Charles Yoss.)

A. North Hollywood, California.

* * * * * [901-1]

Q. (By Mr. Levy): What is your business, Mr. Yoss?

A. I am treasurer and vice-president of the United States Pictures, Incorporated.

Q. Have you any other business?

A. No.

Q. Are you a Certified Public Accountant?

A. No.

Q. Are you an accountant? A. Yes.

* * * * * [901-2]

Q. What position did Mr. Donald Hyde occupy in the company during the time that he was there?

A. Vice-president.

Q. He was not a director, was he?

A. I don't remember.

Q. What were his duties, generally?

A. An executive assistant to Milton Sperling.

Q. Can you give us an idea of what that means?

A. May we go off the record here for a moment?

Q. Yes.

(Discussion off the record.)

The Witness: He reviewed stories; interviewed talent; criticized plays, material; assisted in the production duties [901-5] assigned to him by Milton Sperling and generally duties of this nature.

Q. (By Mr. Levy): What sort of production duties were assigned to him by Mr. Milton Sperling? A. I don't remember.

(Deposition of Joseph Charles Yoss.)

Q. Is that the best answer you can give me to that question?

A. Other than what I told you just before.

Q. Well, I asked you whether you can——

Mr. Williams: Let us not get into an argument with the witness. He has answered your question. Now, let us not start arguing.

Mr. Levy: Mr. Williams, may I call your attention and the witness' attention to the fact that Mr. Donald Hyde received a salary of a thousand dollars a week.

Mr. Williams: Well, what difference does that make?

Mr. Levy: And it seems to me that it is both relevant and material for the plaintiff to know—for the purposes of this trial—what this man was paid a thousand dollars a week for.

Mr. Schwab: He has already told you that he was executive assistant to Sperling and assisted him in everything Sperling had to do.

Mr. Levy: Well, he didn't say that.

Mr. Schwab: Well, I think it was implicit in his [901-6] answer, when he said he was executive assistant to Milton Sperling.

Mr. Levy: I will adopt Mr. Schwab's suggestion.

Q. Did you assist Mr. Sperling in everything that he was called upon to do?

Mr. Schwab: What do you mean, did he or did Hyde?

Mr. Levy: Did Mr. Hyde?

(Deposition of Joseph Charles Yoss.)

The Witness: If Mr. Sperling requested it, I would say yes.

Q. (By Mr. Levy): Would you call Mr. Donald Hyde an assistant producer? A. No.

Q. I take it, then, that he was less than an assistant producer but more than an ordinary employee when you called him an executive; is that the idea? A. Yes.

Mr. Schwab: You called him what?

Mr. Levy: An executive.

The Witness: I would not answer thusly.

Q. (By Mr. Levy): Well, how would you answer the question?

A. As I have heretofore.

Q. And you can't improve on that?

A. That is right. * * * * * [901-7]

Q. Throughout the extended period provided for by the two amendments that I have just read, and down to the present time, has United States Pictures produced any "original" pictures?

A. Not beyond the first three pictures.

Q. Will you please state the names or titles of all pictures produced to date in the order in which they were made?

A. Cloak and Dagger, Pursued, My Girl Tisa, South of St. Louis, Three Secrets, The Enforcer, Distant Drums and Retreat Hell.

Q. It is a fact, is it not, that the first three [901-10] pictures that you named were produced as "original" pictures and the remaining five were

(Deposition of Joseph Charles Yoss.)

produced as "additional" pictures? A. Yes.

* * * * * [901-11]

Q. (By Mr. Levy): Thank you. It is a fact, is it not, Mr. Yoss, that My Girl Tisa turned out to be a financial loss, a loss in excess of a million dollars?

A. There was a loss on My Girl Tisa in excess of a million dollars. [901-30]

* * * * *

Q. In dollars and cents, Mr. Yoss, approximately how much of Warner Bros.' advances to United States Pictures in the form of cash and/or facilities in connection with the cost of production of My Girl Tisa, including all overhead allocated thereto, still remained unrecouped by Warner Bros.?

* * * * *

The Witness: I believe approximately $670,000 as of about March 1st.

Q. (By Mr. Levy): Of 1952?

A. Of 1952.

Q. Will you fill in the exact amount in the space immediately below it? A. Yes.

(Information above requested): $668,108.76.

Q. (By Mr. Levy): In your most recent balance sheet, is My Girl Tisa carried as an asset by United States Pictures? A. Yes.

Q. At what estimated realizable value is it so carried?

A. I don't recall at the moment.

Q. Can you approximate it? [901-32]

(Deposition of Joseph Charles Yoss.)

A. No.

Q. Will you fill in the amount immediately below? A. Yes.

(Information above requested): No realizable value. [901-33]

* * * * *

Q. Is the figure that you will fill in representing the unrecouped monies advanced by Warner Bros. in connection with Mr. Girl Tisa including all overhead allocated to that picture carried on your books now as a debt to Warner Bros.?

A. It is carried on my books as a contingent liability. [901-34]

* * * * *

Q. (By Mr. Levy): Now, you testified, Mr. Yoss, to the total cost of production of the three "original" pictures, namely, Cloak and Dagger, Pursued and My Girl Tisa; that is to say, you gave us the total of each picture. I have totaled these figures and the grand total is $5,170,962.35.

Would you like to check that total?

A. No, I will take your word for it. [901-127]

* * * * *

Now, I ask you this question: In the $5,170,962.35 figure, which you testified as the total cost of the production of the three "original" pictures, was there included the 1946 and 1947 write-offs on literary properties purchased and those written for the company but not used in the production of any

(Deposition of Joseph Charles Yoss.)

picture heretofore produced and charged to U. S. Pictures' overhead?

A. I believe I have answered that in my answers to the interrogatories of a certain date.

Q. Well, can you answer that question yes or no?

Mr. Schwab: Read the question back, will you, please?

(The question was read by the reporter.)

The Witness: Yes.

Q. (By Mr. Levy): And the amount of the 1946 write-off in such connection was $59,935.63?

A. Yes.

Q. And the amount of the 1947 write-off in such connection was $43,656.99?

A. In both instances I have confirmed these answers from interrogatories which I have previously given.

Q. Yes. But is that figure correct?

A. Yes, the figure is correct. [901-130]

* * * * *

Q. Now, you use the words "production overhead." Do you distinguish production overhead from any other type of overhead?

A. Yes. [901-194]

Q. Now, what are the distinguishing features, and how do you run your books on those things?

A. I consider items as being production overhead when they indirectly affect in some manner the production of a picture.

Q. Of a picture produced, you mean?

(Deposition of Joseph Charles Yoss.)

Q. Not at the moment.

A. Maybe representation service, for example, in Delaware.

Q. Everything else is contained in your accounts of production overhead?

A. I charge to production overhead those things [901-196] which indirectly affect the cost of pictures. [901-197]

* * * * *

Q. Can you tell us how Mr. Bernhard's salary was allocated during the time that he was there; how that was divided, as you call it, or segregated?

A. Half of it was charged to production overhead and the other half was charged to production as a direct cost.

Q. And included in the caption "Producer"?

A. Yes.

Q. In the budget of pictures produced?

A. Yes.

Q. Was any part of Mr. Hyde's salary included as a direct charge to pictures produced?

A. No.

Q. Was any part of Mr. Schwab's fees included?

A. No.

Q. Were they included as a direct charge?

A. No.

Q. Or your salary, Mr. Yoss?

A. No. [901-204]

* * * * *

Q. Well, then, what did you say?

A. Our procedure for writing off stories or any

(Deposition of Joseph Charles Yoss.)

other property is that at the end of any given accounting period, each property is reviewed for the purpose of determining if there is any possibility that this story is no longer of value. Such decision is made by Milton Sperling. If he says that this property is not—there is no opportunity that we will use it as a basis for a picture, then it will be charged into overhead. Now, we may make such a review during the month of January, for example, but its effect, however, would be as of the end of the previous year. [901-237]

* * * * *

Q. Were you in the habit of submitting invoices to Warner Bros. at the end of each wee after December 7, 1946? [901-258]

A. It is a regular procedure.

Q. In other words, every week you gave Warner Bros. a list of monies that you had either paid or expanded, that is, incurred or expended, during that week; is that right?

A. That is right.

Q. And you would get a check from Warner Bros. the following week, is that right, or right after you sent this request——

A. Generally your statement is correct.

Q. I beg your pardon?

A. Generally your statement is correct.

* * * * * [901-259]

(Deposition of Joseph Charles Yoss.)

Q. Your answer is interesting to me to this extent and I want to interrogate you on the subject: Am I [901-263] to understand that U. S. Pictures would either purchase a literary property or have a literary property written for it and then at some time or another determine for itself whether U. S. Pictures intends to use such property as the basis for an "Original" or an "Additional" picture?

A. We have the right under our contract to designate a picture as an "Original" or an "Additional" as we choose, before we entered principal photography.

Q. Yes, I am aware of that; and it is with respect to that particular portion of your contract that this interrogation is directed. When, between the time that you either purchased or had a story written for you and that way acquired it, and the time you commenced principal photography, when in that interim do you make a decision as to whether a picture is going to be an "Additional" or an "Original" picture?

A. In the past we have made this decision just prior to principal photography commencement.

Q. You mean on the day before?

A. Maybe a few days before; I don't recall.

Q. It may be a few days before. Then what do

(Deposition of Joseph Charles Yoss.)

you do when you decide that this is going to be an "Additional" picture and not an "Original" picture? Just what do you do?

A. I don't understand your question.

Q. Well, in the first place, you have a meeting of [901-264] your Board of Directors, do you, and you make that determination—or does Mr. Sperling make that determination himself?

A. Well, it would be a subject of discussion between us. I don't think there would be a meeting if——

Q. When you say "between us," you mean between whom?

A. Mr. Sperling and Mr. Schwab and myself.

Q. And Mr. Sperling would indicate his views as to whether he wants this an "original" or an "additional" picture; is that right?

A. It would be discussed.

Q. He would make the decision, would he?

A. His would be the final decision.

Q. After he made that decision, what would he do?

A. I would be—I would know of that decision and then I would see that a letter was prepared and Warners notified as to whether it was either "Original" or "Additional."

Q. Have you such letters in your file?

A. Yes.

Q. And in such letters, do you state to Warner Bros. that you intend to commence principal photography on such and such a picture and you desig-

(Deposition of Joseph Charles Yoss.)

nite this picture as an "Original" or an "Additional" as the case may be?

A. We indicate to them that we designate the picture either as an "original" or "Additional."

Q. I see. Now, at such time as you make such announcement to Warner Bros., you have assembled, have you not, all of the elements of the picture which you are going to shoot?

A. Generally, yes, or at least we are in the process of it.

Q. Well, you have your director, haven't you, under contract?

A. Presumably so, yes. [901-266]

* * * * *

Q. Do you know of any instance in which a director on any picture that you have produced was chosen only a few days before commencement of principal photography? A. No, sir.

* * * * *

Q. (By Mr. Levy): Is there any question but that the [901-268] cast of the picture had been assembled at the time that you made such announcements?

A. Well, the principal cast would obviously be assembled. It is generally the practice all during the picture to pick your minor cast as you go along.

Q. But the principals?

A. Yes, the principals would have been chosen.

Q. And your production manager?

A. Yes.

(Deposition of Joseph Charles Yoss.)

Q. Will you not say that as a general proposition, you had all the elements of the picture assembled which you required in order to commence principal photography when you made that announcement to Warner Bros.?

A. As a general proposition, yes.

Q. And by that time you would have gone through the whole process of entering into numerous contracts with personnel involved in the production of that picture?

A. We would have entered into many contracts.

* * * * * [901-269]

Mr. Levy: Yes. I offer in evidence Exhibit 95-H.

Mr. Williams: The same objection, your Honor.

The Court: Overruled. Received in evidence.

(The document was thereupon marked Plaintiff's Exhibit 95-H and received in evidence.)

* * * * *

"United States Pictures, Inc.
Income Tax Return"

This is the heading on the document that I am reading. The further heading: "Loss on Photoplay My Girl Tisa." And this whole exhibit, by the way, if your Honor please, is denominated Amended Return for Calendar Year 1948 of United States Pictures, Inc. [908]

"Under the terms of an agreement with Warner Bros. Pictures, Inc. dated September 28, 1945, and amended November 2, 1945, December 6, 1947, Feb-

ruary 3, 1948, and July 21, 1950, United States Pictures, Inc. has produced at Warner Bros. studio three 'original' motion pictures and three 'additional' pictures to December 31, 1950.

"With respect to the three original pictures, Warner Bros. Pictures, Inc. financed one-half of the cost of each production and the amounts advanced along with various costs and expenses incurred in distribution have been deducted in full or in part by it from the proceeds of each picture. The first two original pictures, Cloak and Dagger and Pursued, resulted in profits (receipts in excess of all costs and expenses) which in accordance with the terms of the agreement are being shared equally by the two parties.

"With respect to original pictures, subdivision (j) of paragraph Seventh of the agreement provides as follows:

"'There shall be paid to the Producer (United) the share of the gross receipts hereinbefore provided from each photoplay as same are earned, provided that if any photoplay shall result in a net loss then the amount of said loss shall be recouped by the Company [909] (Warner Bros. Pictures, Inc.) from the proceeds of any or all subsequent photoplay or photoplays, in addition to the other charges and costs which it is authorized to retain from such subsequent photoplay or photoplays until it has recouped such loss. If, within four (4) years after the first general release in the United States of America of the last photoplay produced hereunder the Company has not recouped all of the

moneys owing to it pursuant to the terms thereof, then the Producer shall pay to the Company the amount of such deficiency.'

"The third original picture, My Girl Tisa (released in 1948), will result in a loss which the company estimated in its 1948 return would approximate $1,200,000, calculated as follows:

Cost of Production, one-half of which was financed by Warner Bros. and is repayable on basis set forth below	$1,645,066.78
Less—Estimated gross receipts reduced by estimated expenses of distribution	442,746.74
Indicated loss	$1,202,320.04

In the 1948 return the company deducted amortization of this picture in an amount sufficient to reduce all [910] production costs (financed by both the taxpayer and Warner Bros.) to estimated realizable value and allocated one-half ($601,660.02) of the estimated loss to Warner Bros. Pictures, Inc. on the assumption that the losses as well as the profits were to be shared equally by the parties to the agreement. However, legal counsel after considering the aforementioned agreement has decided that the taxpayer was not entitled to deduct in its 1948 income tax return any portion of the Tisa production costs financed by Warner Bros. Pictures, Inc. because United's liability, if any, to reimburse Warner Bros. for such costs is contingent

and is enforceable only if Warner Bros. has not recouped its loss from the gross receipts of subsequent productions within four years after the general release of the last photoplay to be produced under the agreement.

"In view of the above, amended 1948 and 1949 income tax returns are being filed; these returns and the company's 1950 return have been prepared to reflect a loss to United of $403,513.76 on My Girl Tisa, instead of the $601,660.02 shown in the original 1948 return, computed as follows:"

And on the next page the computation is made.

* * * * *

R. J. OBRINGER

recalled as a witness on behalf of plaintiff, previously sworn, testified further as follows: [916]

* * * * *

Direct Examination—Resumed

Q. (By Mr. Levy): When you were last on the witness stand, Mr. Obringer, I had asked you whether you knew the meaning of the words "general purposes," which words are contained in the answer to Interrogatory H in Exhibit 107 in evidence, [917] on page 2 of that exhibit. [918]

* * * * *

Q. (By Mr. Levy): Mr. Obringer, did you yourself frame the answer, namely, H, that we are referring to? A. No, sir.

Q. Am I to understand, then, that somebody else authored the answer?

A. That is correct.

Q. Do you know who its author was?

(Testimony of R. J. Obringer.)

A. No, I do not. The interrogatories were presented to me for my signature as an officer of Warner Bros. Pictures, Inc., and the information which I verified was served by various departments in New York and the local studio.

Q. I take it, this was the situation: there was presented to you Exhibit 107 and you thereupon formally [919] affixed your signature thereto as an officer of Warner Bros.?

A. That is true.

* * * * *

Q. Mr. Obringer, did you have any information with respect to the dates of release of any of these pictures? And when I use the word "release," I refer to general release in the United States.

A. No, sir, none whatsoever. [920]

Q. You never had that information?

A. That information is a New York detail.

Q. So that, if you made answer in these interrogatories with respect to release dates, that also falls in the category of information that has been supplied to you and which you formally verified; is that correct? A. That is correct.

Q. You have, then, no independent knowledge of the dates of release of any of these pictures?

A. None whatsoever. [921]

* * * * *

Q. (By Mr. Levy): Mr. Obringer, I direct your attention specifically to paragraph 5 which I will read to you.

* * * * *

(Testimony of R. J. Obringer.)

The Court: You are referring to Exhibit 4, is it?

Mr. Levy: Exhibit No. 4 in evidence. [929]

* * * * *

Mr. Levy: Well, let me read it again. This is a very poor photostat.

"Paragraph 5. You agree that prior to commencement of principal photography of any of the photoplays hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay as hereinbefore referred to."

Q. Were you the author of that particular paragraph?

A. I would say that that paragraph was worked out either between myself and Mr. Schwab or Mr. Voss purely from a practical standpoint.

Q. Pardon me?

A. Merely from a practical standpoint, if we were going to do an original picture it involved a different type of financing than it would be if it would be an additional [930] picture, and we had to know what we had to do in advance.

Q. That is the explanation for the inclusion of paragraph 5?

A. That is the purpose of the paragraph; yes, sir.

Q. Was that the sole purpose of it?

A. As far as I know, yes.

* * * * *

Q. May I ask you this, Mr. Obringer: At the

(Testimony of R. J. Obringer.)

time that this paragraph was drawn were you familiar with the fact that preproduction of a photoplay might involve the expenditure by Warners or the advance by Warners of large sums of money? When I say "large" I mean sums ranging from $50,000 to a quarter of a million dollars.

A. With respect to the production of photoplays in general?

Q. Preproduction? A. Preproduction?

Q. Yes.

A. Yes, I am familiar with that fact and provided for it by the contracts. [931]

* * * * *

Q. (By Mr. Levy): Do you know, Mr. Obringer, that in the course of the preparation for production of a photoplay, whether by Warner Bros. Pictures or by an independent producer, a script has to be written? A. Yes.

Q. Do you know that?

A. Certainly, I do.

Q. Do you know that the thing starts with a story, whether it be a book, short story, novel or stage play—you know that?

A. I am familiar with that phase.

Q. Do you know that occasionally the purchase of such story, stage play, or magazine short story runs into considerable [932] money?

Mr. Williams: Just a moment. If your Honor please, I object to this question on the ground that it has no relevancy to the issues involved in this case what this witness knows of the subject.

(Testimony of R. J. Obringer.)

The Court: Overruled. He may answer.

Q. (By Mr. Levy): Do you know those things?

A. I have reasonable knowledge that those things take place, yes.

* * * * * *

Q. (By Mr. Levy): Were you aware—put it that way—of the fact that under paragraph 5, United States Pictures had the right to withhold advising Warner Bros. Pictures of whether or not a picture which United States Pictures [933] had been preparing for production, namely, for photography, would be an original or an additional picture up to the very moment that United States Pictures through its directors would step on the sound stages and begin turning the camera; were you aware of that fact?

Mr. Williams: That is objected to as argumentative as to form, and the document speaks for itself.

The Court: Sustained.

Mr. Williams: As to what the rights are.

The Court: You may inquire as to his understanding if you are so advised.

Q. (By Mr. Levy): Did you understand, Mr. Obringer, at the time that this particular paragraph was authored by you that the situation was as I described it in the previous question?

Mr. Williams: That is objected to, if your Honor please, as improper in that it is the question as to which your Honor has already sustained an objection.

(Testimony of R. J. Obringer.)

The Court: Overruled. If the witness understands it. Do you understand the question?

The Witness: No, I do not. Will you repeat it, please?

The Court: I suggest you rephrase it.

Q. (By Mr. Levy): At the time that paragraph 5 was incorporated by you in Exhibit 4 in evidence was it your understanding that United States Pictures had the right to [934] prepare a motion picture,—proceeding from its initial stages, namely, the purchase or other acquisition of the material upon which the picture was based, the processing of it through having it written and developed into a scenario, a shooting script, assembling of a cast therefor, the employment of the personnel, directors, stars, etc.—that United States Pictures would have the right—was it your understanding that United States Pictures would have the right to do all of that which I have just described, and incur the expense embraced in such behavior, and not notify Warner Bros. Pictures as to whether the product of all that I have indicated to you would be used by United States Pictures in the production of an original picture or an additional picture? A. Well——

Mr. Williams: If your Honor please, that is a question which is absolutely argumentative in every sense of the word.

The Court: Overruled.

Mr. Williams: It involves an entire series of matters which are not involved in this question at

(Testimony of R. J. Obringer.)

all, and involves a completely different series of clauses in the contracts involved.

The Court: Overruled. You may answer.

A. Well, the details which you have enumerated did not enter my mind as regards the preparation of this paragraph [935] 5. It was purely designed to put us on notice as to whether or not we were to finance 100 per cent or to provide for 50 per cent of the finances. That was the sum and substance of the paragraph.

Q. (By Mr. Levy): I see. And that is the explanation that you have for it? A. That is.

Q. Were you aware of the fact that Warner Bros., in the case of the picture being an additional picture, would have financed all that I have just described to you in the previous question 100 per cent, whereas if the picture were at the last moment denominated by United States Pictures as an original picture, Warner Bros. would be financing only 50 per cent of such costs? Were you aware of that?

A. Yes, I was aware of it, but, to me, it would be immaterial until we came to the point when we commenced financing whether it shall be 50 per cent or 100 per cent.

Q. It was immaterial? A. True. [936]

* * * * *

Q. Mr. Obringer, at the time you authored Exhibit No. 4 and particularly paragraph 6 of Exhibit No. 4 were you aware of the fact that United had

(Testimony of R. J. Obringer.)

charged as overhead to the picture Cloak and Dagger the sum of $116,801.94?

A. No, sir. That information would be an accounting problem and I wouldn't have any knowledge of it.

Q. So that at the time that this document was drawn by you, you had no idea of how much United had theretofore apportioned to its overhead, is that right?

A. That is right. I had no knowledge and it was not within my province. [958]

* * * * *

Q. I take it, then—and correct me if I am in error—that at the time Exhibit 7 was executed and prior [961] to the time it was executed you, as an individual, had no knowledge of how much United had theretofore allocated to all of the pictures that it had produced up to that time, in the form of overhead?

A. It was strictly an accounting problem. I had no knowledge whatsoever.

Q. Now, Mr. Obringer, will you take Exhibit No. 107 that is before you and turn to the very last page in that exhibit. It is referred to as "Schedule H." That is, is it not, a further amendment to the basic contract, namely, Exhibit 1?

A. That is correct. [962]

Q. Were you the author of that document?

A. I was.

Q. Namely, Schedule H? A. Correct.

Q. Might I ask you whether at the time you

(Testimony of R. J. Obringer.)

offered Exhibit 7, being the July 21, 1951, amendment to the master contract, whether you knew that My Girl Tisa had sustained a loss of approximately a million dollars?

Mr. Williams: If your Honor please, that is objected to as assuming facts not in evidence, to wit, that it had sustained such a loss.

Mr. Levy: The evidence, by the admission of the parties, indicates that My Girl Tisa had sustained a loss of a million and two hundred-odd thousand dollars.

Mr. Williams: There is not any question of a loss on My Girl Tisa at that time or at any time. There was a failure up to that time to have recouped the amount of money that was put into the picture.

The Court: Was there a failure of recoupment at that time?

Mr. Williams: There was a failure of recoupment at that time.

The Court: To the extent of a million dollars?

Mr. Williams: I don't think that much at that time. I think it was around eight hundred thousand dollars at [963] that time.

Mr. Levy: Let me reframe the question, then.

Q. At the time you offered Exhibit 7, were you aware of the fact that there had been a failure to recoup approximately $800,000 on the part of Warner Bros. as the result of the production of that picture?

A. I have no knowledge whatsoever of the prof-

(Testimony of R. J. Obringer.)

its or losses on pictures. I received no such information.

Q. And your answer applies equally, I take it, to Schedule H that is contained on the last page of Exhibit 107? A. It does.

Q. You had no knowledge at that time whether there had been a failure to recoup on the part of Warner Bros. any amount of money?

A. None whatsoever.

Q. And you similarly had no knowledge of how much United States Pictures had allocated to the production cost of any picture and all pictures that it had produced prior to August 12, 1952?

A. I don't understand your question.

Q. Let me reframe it, then. On August 12, 1952, or immediately prior to that time, when you authored the document which is indicated as Schedule H in Exhibit 107, at that time or at those times you had no knowledge of how much United States [964] Pictures had allocated as United's overhead to the production cost of all pictures theretofore produced, or any picture theretofore produced, by United up to that time?

The Witness: Your prior question did not inform me that the allocation pertained to overhead, but my answer is I absolutely had no knowledge.

Mr. Levy: That is all.

Cross Examination

Q. (By Mr. Williams): Mr. Obringer, just a couple of questions with respect to Exhibit 7. I

(Testimony of R. J. Obringer.)

understand that you received your instructions to draw that document from Mr. Sam Schneider.

A. That is correct.

Q. And, after that document had been prepared, you stated the substance of it to Mr. Jack Warner, who approved it?

A. Who approved my signing it as an officer of the corporation.

Q. Did you prepare the document without assistance from anybody else?

A. Yes, I did. Having the facts from Mr. Schneider, this was more or less of a duplication of the previous amendment. [965]

The Court: Does the record show who Mr. Schneider is?

Mr. Williams: Mr. Sam Schneider, a vice president and director of Warner Bros.

Q. That is the Sam Schneider you are referring to? A. Yes.

Q. Who at that time happened to be on the Coast? A. He was in the Coast Studio.

Q. The point I was trying to make was that there was not any negotiation between you and any attorney or other person representing United States Pictures as to the phraseology of that Exhibit 7?

A. No; except to this extent: that Mr. Schneider gave me the details, which were outlined to Mr. Warner, who issued approval for the draft of the document; it was prepared and I recall submitting it to Mr. Schwab, attorney for United, for his acceptance or rejection, and it was accepted.

(Testimony of R. J. Obringer.)

Consequently, the document was executed; copies were disbursed, copies sent on to the trust department in New York.

Q. In Schedule H attached to Exhibit 107, that is the contract of August 12, 1952, from whom did you get your instructions as to writing that contract?

A. I received a telephone call from Mr. Herbert Freston of the law firm of Freston & Files, Warner Bros. [966] West Coast retainers, to the effect that he had had a conversation with an officer of United regarding the preparation of the document to call for two additional pictures, and stated inasmuch as I had theretofore prepared amendments of similar character, he suggested I prepare it, which I did, and submitted it to Mr. Schwab.

Q. Was it accepted without modification, Mr. Obringer?

A. Well, there was some discussion between Mr. Schwab and me on form. I had prepared a draft which paralleled the July 21 agreement by referring to various subdivisions, and Mr. Schwab indicated that perhaps it was a little too verbose in language, and to just reduce the fact to the substance of it, that I had submitted two pictures and extended the term three years.

I thereupon saw no objection to it, and revamped the amendment and sent it over for acceptance by him, which he did, and it was subsequently concluded. * * * * * [967]

(Testimony of R. J. Obringer.)

Redirect Examination

Q. (By Mr. Levy): I don't quite remember whether I asked you whether you got Mr. Jack Warner's O.K. on the August 12 Schedule H of Exhibit 107. A. I did, sir. * * * * *

Q. And he said, in effect, "O.K., go right ahead"?

A. "It is approved to execute."

* * * * * [969]

Mr. Levy: May I, until he returns, your Honor, read a portion of the Statement of J. S. Yoss, who is the accountant for the United States Pictures, into the record.

The Court: A statement or a deposition?

Mr. Levy: It is his statement under oath, and this document was subscribed, sworn to and served upon me pursuant to an agreement had between Mr. Schwab and myself following a motion that had been made before your Honor and came on duly to be heard for an order directing Mr. Yoss to answer questions that he had refused to make answers to during the course of his deposition, and as a substitute for making answers in accordance to the questions that were propounded to him, he made this statement which we accepted in lieu of his making an answer to each such question.

The Court: It should be offered in evidence, should it not?

Mr. Levy: The reason why I am not offering the whole statement in evidence is because it treats with other matters [980] separate and apart from

the questions that he was asked which were involved in the motion which was brought on before your Honor.

The Court: Let it be marked for identification.

* * * * *

The Court: The Yoss statement just referred to will be marked Plaintiff's Exhibit 126 for identification. * * * * *

Mr. Williams: If your Honor please, knowing the contents of that statement, which your Honor of course does not know at this time, I wanted to interpose an objection on the ground it is not relevant to the issues now being tried before this court. The statement has to do, if I remember correctly, principally with the two matters: One is the matter of the sale by Mr. Bernhard of his stock to Mr. Sperling, and the other is the matter of the creation of the trust in favor of the children of Mr. and Mrs. Sperling. We cannot concede that that has any relevancy to the issue now before this court. For that reason we object to it on that ground.

The Court: Overruled. [981]

Mr. Levy: Paragraph 10 in Exhibit 126 for identification reads as follows:

"10. Statement of facts concerning loan by Milton Sperling of $400,000 from the New York Trust Company: The $40,000 sum referred to on page 50 et seq of the August 13, 1952 session of the J. C. Yoss deposition was borrowed by Milton Sperling from the New York Trust Company on September

16, 1946. Milton Sperling executed a promissory note for said sum dated September 16, 1946. Betty Sperling deposited certain stock, owned by her, of Warner Bros. Pictures with the New York Trust Co. as security for repayment of the loan. Milton Sperling has paid all interest due on said loan since that date. Milton Sperling paid $100,000 on account of the principal of said loan on or about December 27, 1946, reducing the unpaid balance to $300,000, which is the present unpaid principal amount of the loan;

11. Statement of facts concerning Title Insurance and Trust Co. trusts: On or about December 23, 1946, Milton Sperling and Betty Sperling, as Trustors, established two trusts with the Title Insurance and Trust Company as Trustee. One of these trusts had as its primary beneficiary Susan Sperling, daughter of Milton and Betty Sperling, and the other trust had as [982] its primary beneficiary Karen Sperling, daughter of Milton and Betty Sperling. The Trustors made gifts to each of said trusts of $52,700 and 15 shares of United States Pictures stock. Thereafter, and also on December 23, 1946, the Title Insurance and Trust Company, as trustee of each of said trusts, purchased from Milton Sperling 16 shares of stock of United States Pictures, Inc., for each trust, for the sum of $51,200 for said 16 shares. Each of said trusts accordingly now owns 31 shares of stock of United States Pictures, Inc."

This statement was signed by J. C. Yoss, sub-

scribed and sworn to before Oliver B. Schwab, Notary Public in and for the County of Los Angeles, or in and for said county and State of California, Mr. Schwab?

Mr. Schwab: Oh, yes. * * * * * [983]

Mr. Levy: I do not recall, your Honor, whether the deposition of Mr. Yoss stated this fact clearly or not, but if it does not, I belive we could save time, instead of putting the witness on the stand in order to bring this back into the record. It is:

That on the 3rd day of March, 1947 United States Pictures borrowed the sum of $150,000 from The New York Trust Company. The collateral for that loan was not any of the pictures that are involved in this litigation. The collateral for said loan was the personal guarantee by Harry M. Warner of that note.

If we can have that fact stipulated in the record, I think we can save time, the fact being, namely, on March 3, 1947 United States Pictures borrowed $150,000 from The New York Trust Company. On that day it made, executed and delivered to The New York Trust Company its note in the sum of $150,000; that that note was endorsed by Harry M. Warner. [984]

Mr. Williams: We stipulate that those are the facts, but we object to the facts on the ground they do not tend to prove the issue now being tried before this court or any part thereof.

The Court: Overruled. The facts as stipulated are received in evidence.

Mr. Levy: May we have a stipulation as to this further fact, namely, that the note in question was a demand note; further, that United States Pictures has to date paid on account of said note the sum of $45,000 and that there remains due, owing and unpaid by United States Pictures to The New York Trust Company on said note the sum of $105,000?

Mr. Williams: We will stipulate that, subject to the objection which we have made, with the further statement that they have paid in addition to the $45,000 interest on account of that said loan.

Mr. Levy: Very well, sir.

The Court: You make the same objection to the facts so stipulated?

Mr. Williams: The same objection, yes.

The Court: As made to the previous stipulation?

Mr. Williams: Yes, your Honor.

The Court: Objection overruled. The facts as stipulated are received in evidence.

* * * * * [985]

The Court: Exhibit C for identification is received in evidence.

(Defendants' Exhibit C for identification was thereupon received in evidence.)

* * * * * [992]

Mr. Williams: I will call Mr. Herbert Freston.

HERBERT FRESTON

called as a witness on behalf of defendants, having been duly sworn, testified as follows:

The Clerk: State your name to the court.

The Witness: Herbert Freston.

The Clerk: Will you state your address?

The Witness: 650 South Spring Street, L.A. 14.

Direct Examination

Q. (By Mr. Williams): What is your occupation, Mr. Freston?

A. I am an attorney at law.

Q. How long have you been admitted to practice?

A. This coming July will be 40 years.

Q. You have been practicing during that entire time in what locality?

A. In Los Angeles, with the exception of about two years in the Army Air Force in World War I.

Q. Are you at the present time connected with any law firm? [993]

A. The law firm of Freston & Files.

Q. And you are the Freston of Freston & Files?

A. Correct.

Q. In connection with your work as a lawyer, have you occupied any official positions at the bar?

A. President of the Los Angeles Bar Association, 1940 to 1941; a member of the Board of Governors of the State Bar of California, term expiring in 1947; and Vice President of the State Bar of California.

Q. During the course of your practice have you

(Testimony of Herbert Freston.)

had anything to do with the matter of representing persons or corporations in the motion picture industry? A. I have.

Q. Beginning at what time?

A. My first contact with the motion picture business, I think, was in 1916, at which time I was in the office of counsel representing Paramount Pictures in this location, or in this locality.

Q. At that time did you perform services in connection with problems arising out of the motion picture industry?

A. I began to at that time, yes, sir.

Q. Have you ever since that time had connection as an attorney with the motion picture industry? A. Since about 1923, quite actively, yes.

Q. In 1923 what did you undertake in the way of professional work in the motion picture industry?

A. In that year our firm became counsel, West Coast counsel, for Warner Bros. Pictures, Inc.

Q. Has your firm been counsel for that corporation ever since? A. It has.

Q. Has that work been an active representation of that corporation?

A. Very active.

Q. In the course of that business, have you personally attended to many of the affairs of Warner Bros. Pictures in a legal way? A. I have.

Q. During that time have you had anything to do with the drawing of the so-called production-distribution contracts?

(Testimony of Herbert Freston.)

A. Yes, I have drawn several, and participated by way of conferences and assistance in the drawing of a number of others.

Q. About what was the date of the first such contract you ever drew?

A. The first one was between Warner Bros. and Cosmopolitan Productions, which was, I think, in 1934 or 1936.

Q. That was the one involving the services of [995] Marion Davies? A. Correct.

Q. Then, at a later time, did you or your firm have something to do with the drawing of this contract which has just been marked in evidence as Defendants' Exhibit A-17-1 to -5, inclusive, that is, the Frank Capra 1940 contract?

A. Yes. Our office drew that contract. The actual dictation, I think was done by Mr. Lewis, but we all conferred with respect to the preparation of it.

Q. Are those the two contracts that you now remember that you personally participated in prior to the matter involved in this case?

A. That's correct.

Q. You have spoken of your firm as being attorneys for Warner Bros. Pictures, Inc. since 1923. Do you in that capacity represent the firm at all places or just on the Pacific Coast, the West Coast?

A. The West Coast.

Q. Does the firm have counsel in New York, who operate at the New York offices and represent them in matters that arise in New York?

(Testimony of Herbert Freston.)

A. Yes; the general counsel's office is in New York City, with whom we are in contact continuously.

Q. In other words, as problems arise, you and they [996] confer with each other concerning those problems? A. That is correct.

Q. Who is the general counsel of Warner Bros. Pictures? A. Mr. Robert W. Perkins.

* * * * *

Q. Is Mr. Stanleigh P. Friedman also an attorney for Warner Bros. Pictures, Inc. in New York?

A. Yes, he is.

Q. And Mr. Joseph P. Karp, who is gracing this courtroom with his presence? A. Yes.

Q. He is one of those attorneys, and has been for a number of years?

A. Many years. * * * * * [997]

Q. Mr. Roy J. Obringer was with us here. Is he connected with your firm? A. He is not.

Q. What is his capacity with Warner Bros. Pictures, Inc.?

A. He is what we refer to as lot counsel, or resident counsel, at the studio of Warner Bros. Pictures, Inc., in Burbank. * * * * *

Q. (By Mr. Williams): Speaking generally, what is the character of matters handled by Mr. Obringer and those handled by your firm?

A. Mr. Obringer is in charge of what we refer to as [998] the contract department at the Studio. He draws contracts of various kinds with talent whose services are used in the pictures. He takes

(Testimony of Herbert Freston.)

care of the exercise of options under contracts, and takes care of notices where notices are called for under contracts. He drafts amendments to those contracts and also sits in as a studio executive with Mr. Jack Warner and others on the lot in the negotiation of contracts. * * * * * [999]

Q. I will ask you whether sometime in August of 1945 you had a conversation with Harry M. Warner in respect of a proposed contract between Warner Bros. Pictures, Inc. and United States Pictures? A. I did.

Q. When and where did that conversation take place?

A. I believe the conversation took place at Mr. Warner's ranch home in the Calabasas area on a Sunday afternoon immediately preceding the drafting of that contract.

Q. Can you fix the date of that conversation?

A. I believe that was on Sunday, August 19, 1945.

Q. What was the substance of what was said by Mr. [1000] Warner to you at that time and what did you say to him on this subject?

A. Mr. Warner told me in substance that he was not a production man; that he was the over-all supervisor of operations of Warner Bros. Pictures, Inc.; that he was very much concerned concerning the health of his brother Jack, who was in charge of production at Warner Bros. Studio.

He told me, as he put it, that Jack had been hauled out of the studio in an ambulance, and that

(Testimony of Herbert Freston.)

the family doctor, Dr. Hirschfeld, had come to Mr. Warner and told him that his brother might be seriously ill, and that since Jack was in charge of production, that he, H. M. Warner, should do something about getting the studio ready to carry on in the event anything happened to Jack.

He also told me at that time that Joe Bernhard, who had been with the Warner organization a number of years, was leaving that company for the purpose of going into independent motion picture production.

He told me that Joe Bernhard had already organized a corporation to engage in that production, and that it was the plan to have Joe Bernhard join with Milton Sperling to form an independent producing unit to produce motion pictures on the Warner lot for distribution through the Warner distributing agency. [1001]

Mr. Warner told me that Sperling, whom I had known since 1932 myself, had had considerable production experience and that he, Warner, had a great deal of confidence in both the ability and integrity of Sperling and he thought it would be an ideal combination to set up such a concern to produce pictures on Warner lot for the purpose of supplying Warner with pictures vitally needed for exhibition in the theatres and for distribution, and, at the same time, as a result of the additional experience which Sperling would attach in that production program, enable him to evolve into a producer of great ability and understanding, to the

(Testimony of Herbert Freston.)

end that if anything should happen to J. L. Warner, Sperling would be able to render his assistance in keeping the Warner production program going.

Warner told me that he had confidence in Sperling, in his honesty and his ability, and that had he been obliged to turn elsewhere now to get some other producer in whom he had confidence, he would not know where to turn.

So he said this corporation would enter into a contract with Warner Bros. Pictures to produce on the Warner lot for Warner distribution——

Mr. Levy: May I interrupt for a moment. By "this corporation" may the witness indicate what he means?

A. It is the corporation, Mr. Levy, that subsequently became known as the United States Pictures, Inc., the [1002] original name being known as the Comet Productions, Inc. which Mr. Bernhard had incorporated himself through his own counsel in New York City, Simpson, Thatcher and Bartlett, I think, did the work.

Now, at that point Mr. Warner asked me to draw that contract. He said, "I would appreciate it if you would take personal charge of it."

At that point I asked him some questions. I said, "First of all, you realize that Sperling is your son-in-law."

He said, "Of course I do. What I want here is simply a contract that is fair both to Warner Bros. and the independent producer. For that reason I have asked you to draw that contract and I am con-

(Testimony of Herbert Freston.)

fident that you will make it a fair and workable arrangement." I said to him—asked him some of the highlights of what the deal was to be. I said, "What is the distribution charge going to be"?

"Well," he said, "that has not been definitely decided yet but I have contacted the New York office and I am told that we could distribute that picture for around 14 or 15 per cent."

I also asked him—— [1003]

* * * * *

A. ——what the overhead charge would be on the furnishing of facilities by Warner Bros. to this independent production corporation.

He told me at that the United States Pictures would not use all of the services normally rendered by Warners to an independent producer, since it would be an independent producing unit on its own account, and therefore he was having Price, Waterhouse & Co., certified public accountants, determine on the basis of executions just what the proper overhead would be under this contract—a rate that would be fair to both Warner Bros. and to the producer. He told me also that Price, Waterhouse would put that in letter form and that would simply be a part of the contract.

Q. Was anything said as to the number of pictures proposed to be produced?

A. Yes, I asked him that. He told me that the plan then agreed upon tentatively was to produce six pictures over a period of three years.

(Testimony of Herbert Freston.)

Q. Was anything said as to how the pictures would be financed?

A. At the outset nothing was said about how the [1005] pictures would be financed, except to say that Warner Bros. would furnish a half of the production costs and United States Pictures the other half of the production cost.

Q. What further was said in that conversation?

A. He said that he had had a number of conferences with Mr. Bernhard and that he and Mr. Bernhard had agreed tentatively upon the highlights, some of the principal provisions of this contract. I asked him generally what they were and he said, "Bernhard and I have talked it over. If you will see Bernhard, he will give you the highlights of our agreement."

Q. Was that the substance of that conversation?

A. I think it was. It was a long conversation, Mr. Williams. Many things were said, and I think that is the highlights of it.

Q. That, as you have stated, was on the 19th of—— A. August, 1945.

Q. ——August, 1945. What then did you do with reference to this proposed contract?

A. I went down to the office on the next morning, which was Monday morning, and when I arrived there I found that Mr. Obringer had been to the office on the preceding Friday when I was in San Francisco and had left at the office a draft of a contract which he had prepared, a production-

(Testimony of Herbert Freston.)

distribution contract between Warner Bros. Pictures and Michael Curtiz Productions. That, however, was not a formalized or executed contract, simply a draft that was retained in the process of working out an agreement between Warner Bros. and Michael Curtiz Productions.

That contract I examined very carefully. Also, at the time I had before me the Frank Capra Productions contract offered in evidence as Exhibit——

Mr. Williams: That is the one that has been marked A-17-1-5, inclusive. [1007]

* * * * *

Mr. Williams: I think you had stated that you had examined it?

A. I did examine that contract very carefully. I also examined carefully at that time the Frank Capra Productions contract in evidence here as No. A-17, Exhibit A-17. The Frank Capra—or, rather, the Michael Curtiz Productions draft that I have referred to appeared to me to be a very suitable form and a form that I was eminently satisfied with so far as its general provisions were concerned. And therefore, in view of the great rush in turning out the first draft of what is now Exhibit No. 1, since it was turned out in just one day, I had recourse to a number of general provisions incorporated in the Michael Curtiz contract which I concluded were most satisfactory to Warner Bros. under this contract. [1008]

Q. Did you have anything else before you when you started to draft this contract?

(Testimony of Herbert Freston.)

A. Yes, I did. I also had before me the summary of the highlights agreed upon, so Mr. Warner said, between him and Mr. Bernhard.

Q. And from what source did you get that?

A. I don't remember where I got that. My impression is that it was handed to me by Mr. Bernhard. It might have been at my office on Monday morning with the other papers Mr. Obringer left. That I cannot recall, Mr. Williams.

Mr. Levy: May I inquire at this time if the witness is referring to a document when he says "a summary"?

The Witness: I am referring to a document, Mr. Levy, which I will be very happy to present.

Q. (By Mr. Williams): Will you state what length of time you took in drafting or making the first draft of this contract which ultimately became the Exhibit No. 1?

A. The first draft of this contract was finished about a quarter of 11:00 p.m. on the night of Monday, August 20, 1945.

Q. And after having completed that first draft what, if anything, did you do with it?

A. I went out to the studio, I believe the next day, and had a conference, I believe with Mr. Obringer, one or both of the Warners, and I do not recall whether Mr. Schwab [1009] was there or not.

Q. Following that did you then make some amendments or changes in the first draft?

A. Yes, I made a number of amendments and

(Testimony of Herbert Freston.)

changes in the first draft, and that first draft as the result of those changes and revisions became the second draft.

Q. At the time that you discussed the first draft with Mr. Bernhard and one or more of the Warners and whoever else was there do you remember what the substance of that discussion was?

A. Well, there were a number of changes made in it. I don't recall just what they were at the moment. However, in preparing that first draft, in view of the uncertainty as to what the distribution charge was, I left the distribution charge blank in that contract. As a result of the conference regarding that first draft, somebody at that conference wrote in the figure of "15"—"15 per cent distribution charge" in the blank space which I had left in that contract.

I came back to the office following that and, as I say, worked on the second draft and I think I finished that late the following night.

Q. What did you do with the second draft?

A. The second draft, I believe I left a copy of it at the Beverly Hills Hotel for Mr. Bernhard so that he [1010] and his counsel, Mr. Schwab, could examine it.

Q. And what did you do following that?

A. Well, following that I had an extended conference with Mr. Schwab in my office a few days after that. The conference was held in our office between Mr. Schwab and me on August 27, 1945. Mr. Schwab wanted a number of changes in that

(Testimony of Herbert Freston.)

contract, some new paragraphs, some additions. We discussed that perhaps an hour or two.

As a result of that negotiation between Mr. Schwab, representing U. S. Pictures, and me on behalf of Warner Bros. Pictures, we agreed on a number of changes in that contract. Some I did not agree to. It was an arm's length negotiation.

* * * * *

A. Mr. Schwab was in my office, representing the United States Pictures, and I at the time was representing the Warner Bros. Pictures. I went over the suggestions that he had in mind, which changes and additions, some of which [1011] we argued over for some time, some of which I gave in on, some of which I did not, and it was also agreed at that time with respect to certain clauses that Mr. Schwab wanted, that I agreed to if he himself would draft those suggested clauses and submit them to me in letter form. He did that.

Q. (By Mr. Williams): Are you able to remember at this time, without referring to any notes or memoranda, what the particular points were that were discussed between you and Mr. Schwab?

A. I could not remember all of them without referring to Mr. Schwab's letter and to my notes, but one of them related to the budget. In my first draft I had provided that the budget for the picture was subject to the approval of Warner Bros. Pictures, Inc. Mr. Schwab requested that that clause be so changed as to provide for a budget

(Testimony of Herbert Freston.)

of $850,000 not subject to approval but subject to Warner's approval if the budget exceeded that sum.

Also Mr. Schwab and I in our discussion, in arguing over the budget provision, considered the matter of Warner Bros. unreasonably withholding its approval of any budget; and also we argued with respect to the right of Warner Bros. to question any single item a part of the budget. He asked that the clause be so changed that Warner should not have the right to object to any single item in the budget, and inasmuch as my clause provided that Warner should have the [1012] right of approval if the budget exceeded $850,000, that seemed perfectly satisfactory to me and I said, "Okay," and I prepared that accordingly.

* * * * *

Q. What was your opinion at that time of the effect of Warner Bros. having the right to approve or disapprove the budget as a whole?

A. I thought that was amply sufficient for Warner Bros.' purposes and would afford full protection to my client, knowing, as I did, that it was a rare exception at that time for any quality picture to be made at a cost of as little as $850,000. [1013]

* * * * *

Q. I think we had reached the point where the question before the witness was whether he would, by the aid of referring to his notes, state what were the points in issue between himself and Mr. Schwab at this conference which they held concerning the

(Testimony of Herbert Freston.)

contract which ultimately became Exhibit 1 in this case.

A. I think I can give you all of those if you wish.

Q. Yes, if you will.

A. I have a sheet in my File 18465 here, marked Exhibit G for identification, all of which is in my own handwriting, marked at the right-hand top "8-27-45 O. B. Schwab and H. F.," referring to Oliver B. Schwab and [1017] Herbert Freston. On that sheet the following items appear:

"Paragraph 4-Budget. No approval necessary unless budget exceeds $850,000, and if approval required, then as to budget as a whole and not as to separate items. If in excess of $850,000, company will not be arbitrary or unreasonably withhold approval."

Opposite those two items I have marked: "See J. L. W.," meaning Jack L. Warner. And at the time I made those marks to indicate that those two items Mr. Schwab requested I had to obtain Mr. Warner's approval on.

Q. Did you call Mr. Warner?

A. I did.

Q. What was the conversation between you and Mr. Jack Warner?

A. He said that the clause as I read it to him was satisfactory.

Mr. Levy: That is Jack L. Warner?

The Witness: Jack L. Warner.

Q. (By Mr. Williams): Let me ask you this:

(Testimony of Herbert Freston.)

Why did you call Jack L. Warner rather than Harry Warner in connection with that matter?

A. Because Jack L. Warner is vice-president in charge of production. He has had long experience in the production of motion pictures, and since he is in charge of that activity at the studio and Mr. Harry M. Warner is not and is not a [1018] production man, necessarily I contacted J. L. Warner.

The second item deals with Paragraph 31st. My notes say: "May do outside picture if no default hereunder."

And a further note says: "This is 32 in final draft." Underneath that I have in my own handwriting: "See J. L. Warner."

Q. Did you see Jack L. Warner?

A. I did see J. L. Warner and he did approve of U. S. Pictures making an outside picture at some other studio so long as it was not in default under the provisions of the basic agreement.

Perhaps I had best explain, Mr. Williams, that the final draft of Exhibit 1 included, I think, an additional paragraph which was made in New York before the contract was signed which I did not have in my draft, and that accounts for the changes from 31 to 32, etc.

The next item dealt with material appearing on page 5 of the second draft of this contract which I had prepared. It says: "If producer buys literary property and company pays half of the cost, and if the property is not used by the producer, the pro-

(Testimony of Herbert Freston.)

ducer shall reimburse the company for the company's contribution toward the purchase price."

That provision was discussed between Mr. Schwab and me and was incorporated by me, at my request, in the final draft.

The next item deals with material appearing on page 1 [1019] of Exhibit 1 as it then stood. It says: "50-50 costs of production, but producer may, at its option, require company to contribute less than 50 per cent without otherwise affecting the pay-off, that is to say, 50 per cent to Warner and 50 per cent to producer under the deal." Opposite that item on this page I have these words: "Oliver to draft clause." And that was one of the clauses we agreed that Mr. Schwab would draft, and during that negotiation I had agreed with him that that would be satisfactory for Warner Bros.

Q. Was there anything stated as to the reasons for that clause?

A. Yes. Mr. Schwab said to me that it was quite likely that this enterprise would be successful and that the returns from one or more of the early pictures would come in in such amounts that U. S. Pictures would be in funds and therefore would like the opportunity of using that extra money toward production costs in excess of the 50 per cent. And I also think he explained to me that if U. S. Pictures had created a surplus and did not use it in connection with the production purposes, they might be subject to tax under Section 102 of the Internal Revenue Code, and therefore

(Testimony of Herbert Freston.)

they wanted to do something constructive with their money. I agreed with that problem.

The next memorandum, it says: "Lawsuits. If either [1020] party suffers any losses in re any picture re suits of third persons, defamation, privacy of literary property, etc., any such losses, including legal fees, borne equally by deducting from proceeds. If not sufficient proceeds, then the producer bears the loss."

And the memorandum opposite that provision shows the words: "Oliver to draft."

The next item dealt with the material appearing on page 24 of the second draft. We then had under discussion "re sale of stock. See notes. See J. L. Warner."

That clause, I believe, dealt with the right of U. S. Pictures to sell the stock to some other person, firm or corporation. It was my insistence that no such right be given because of the confidence that Warners had in the U. S. Pictures setup. We wanted to retain that organization and we provided, therefore, that the stock should not be sold except from one of the stockholders to the other.

The next item shows: "Page 1 in paragraph first. Producer may wish to make more than two pictures in any given year."

That was the subject under discussion.

The next item dealt with Section 4½ of Paragraph Seventh, page 14 of the second draft, merely a request to change "production overhead" to "op-

(Testimony of Herbert Freston.)

erating and general overhead." That request was made by Mr. Schwab. I agreed to it. [1021]

* * * * *

The next point in my memorandum states, page 5:

"Eliminate on line 5 the word 'necessarily.'"

I agreed with Mr. Schwab that the word "necessarily" might go out.

Q. Will you give us the language so we can understand what that was about?

A: Yes. On the top of page 5, the second draft, Exhibit G for identification:

"The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are reasonably incurred in connection with such production program."

The word "reasonably" was stricken.

Mr. Levy: At Mr. Schwab's request?

The Witness: At Mr. Schwab's request, and I agreed with that. [1027]

My next item also states:

"Page 5, eliminate four lines, crossed out."

I have actually erased those four lines out of this draft of the second draft, which I actually did, but I may be able to find them for you in the first draft.

I do not have those four lines. They were actually erased by me, but in lieu of those four lines I

(Testimony of Herbert Freston.)

inserted a provision I wanted as a result of our conference and I will read it to you:

"Where the Producer shall enter into contracts with creative or artistic personnel, such as, but not limited to, directors, writers, actors, producers and the like, in connection with the preparation and production of the photoplays herein provided for, the Company will, on proper vouchers and billing from the Producer, pay to the Producer a sum equal to one-half of the moneys payable under such contracts, respectively, weekly, or from time to time, as such moneys become payable."

I have then inserted the next four lines in my own handwriting in pen and ink, and reading as follows:

"But only for such services as may have been rendered by any such personnel in or in connection with any photoplay to be produced hereunder."

The reasons for that I can give you, if you wish, [1028]

Q. (By Mr. Williams): What were the reasons for it?

A. The reasons were so the Producer couldn't load the pictures with a lot of talent of its own, and there was the same provision with respect to literary property. They had to be properties bought for use in one of the photoplays, or for artistic personnel employed to render services in one of these pictures.

* * * * * [1029]

(Testimony of Herbert Freston.)

The next item shows:

"Paragraph Fifth:"—I have quote marks around this:

"'In notice required under paragraph Fourth, the Producer will notify the Company as to facilities required by it in production of each photoplay hereunder.' This goes in and whole of Fifth eliminated."

Q. (By Mr. Williams): Can you tell us what that particular matter was?

A. Yes. Paragraph Fifth as originally prepared by me and which was eliminated reads as follows:

"The Producer, within blank days prior to the date set for the commencement of production of any photoplay provided to be produced hereunder shall submit a budget of the facilities required for each of such photoplays so to be produced. Since the [1031] Company has agreed to pay one-half of the cost of production of each photoplay provided to be produced hereunder, and in order that it may be advised in advance of expenditure as to the nature and extent of its obligations hereunder, such budget and facilities required for each of said photoplays shall be subject to the approval of the Company, but in this connection the Company agrees that it will not be arbitrary or unreasonably withhold approval of any budget or any item in such budget."

Mr. Levy: May I ask what page the witness was reading from in the exhibit?

(Testimony of Herbert Freston.)

The Witness: I am reading from page 8 of my second draft, and go over to the first line on page 9.

Mr. Levy: Thank you, sir.

The Witness: And all of that was eliminated as a result of the conference between Mr. Schwab and me, and in lieu of the elimination these words were inserted, or the substance of these words:

"'In notice required under paragraph Fourth, the Producer will notify the Company as to the facilities required by it in the production of each photoplay hereunder.' This goes in and whole of Fifth eliminated."

And this was put in: [1032]

"In the notice from the Producer to the Company required under paragraph Fourth hereof, the Producer will notify the Company as to the facilities required by the Producer in connection with the production of each photoplay to be produced hereunder." [1033]

* * * * *

Q. (By Mr. Williams): Let us go back before we proceed with what you did with that after the final draft, let us go back to the subject of where you got the material and information and phraseology for the making of this agreement which ultimately became Exhibit 1 in this case and which, in the form that you have before you, is Exhibit I for identification.

You did, did you not, look to certain material which you had on hand before you to get some of

(Testimony of Herbert Freston.)

the clauses and some of the ideas that are included in this agreement?

A. Yes, I did, many of the clauses which I call more [1041] or less standard clauses.

Q. To what sources did you look for the material and the form and the language that you finally incorporated in this agreement?

A. Some of the clauses and some of the language I took word for word out of the Curtiz draft.

Q. That is Exhibit H?

A. Exhibit H for identification.

Q. Yes. And from what other sources did you get either words or ideas?

A. Some ideas I got from the Bernhard memorandum having the highlights of the points that he and Mr. H. M. Warner had agreed upon with respect to the deal.

Q. That is memorandum that is in the bottom of Exhibit G for identification, is it?

A. Correct. And other paragraphs I wrote out myself or dictated. Many of them I wrote out myself in my own handwriting while the girl was copying the preceding paragraphs, in an effort to get this out in a hurry.

Q. Have you made an analysis of this agreement Exhibit 1 in this case for the purpose of determining the sources from which the various ideas and language which you placed therein were obtained? A. I have.

Q. And have you made notes of that for your own [1042] convenience in testifying?

(Testimony of Herbert Freston.)

A. I have.

Q. Do you have those notes with you?

A. I do.

Q. I presume that, without referring to the notes, it would be rather a long and arduous task for you to undertake to point out the source of each of the paragraphs of the final agreement, would it not?

A. In view of the fact that almost eight years has elapsed since I put this together, I would say that it is a very difficult task, Mr. Williams.

Q. Well, at any rate, by referring to the notes which you have made you can sufficiently refresh your recollection so you can testify as to the source of the matter contained in the agreement, can you not? A. I believe I can.

Q. Now, with reference to the first paragraph, the introductory language in the first paragraph, what was the source of that language?

Mr. Levy: The first paragraph of what, Mr. Williams?

Mr. Williams: The introductory language in the first paragraph of the agreement Exhibit 1.

The Court: Has a schedule been made, a written schedule of these sources?

Mr. Williams: Yes, your Honor. [1043]

The Court: Does the witness testify that he made it?

The Witness: I made it, your Honor.

The Court: You have, out of court, compared

(Testimony of Herbert Freston.)

the contents of Exhibit 1 with the source material you used in drafting it?

The Witness: That is correct, your Honor.

The Court: You made a list of the sources with reference to the various parts of Exhibit 1?

The Witness: I have.

The Court: Do you have that with you?

The Witness: I do have it with me.

The Court: May it be introduced as the witness' testimony? [1044]

* * * * *

The Court: Very well. Then the document that we have been discussing may be received in evidence, and will be received as Defendants' Exhibit J, Mr. Clerk.

The Clerk: J, yes, your Honor.

(The document marked Defendants' Exhibit J, was received in evidence.)

Mr. Levy: Do I understand that I am to receive copies? [1048]

* * * * *

(Defendants' Exhibit J in evidence is copied into the record in the following words and figures, to-wit:)

Statement re Source Material

Counsel for the plaintiff in this case has submitted to some of the defendants certain detailed interrogatories dated October 28, 1952, and a number of the interrogatories presented make inquiries

Defendants' Exhibit J—(Continued)

as to the source material of certain provisions appearing in the WBPI-USPI Production-Distribution Agreement of September 28, 1945, hereinafter referred to as the "Basic Agreement." [1049]

As will be observed from the statement of Herbert Freston with reference to the circumstances leading up to the preparation of the basic agreement, the basic agreement in two or three drafts was drawn under great pressure and within a few days from the time the matter was submitted to us. The first draft of the document was turned out in one day until late at night of the same day.

In the nature of things, many of the provisions found in a production-distribution agreement are provisions prepared by counsel as a result of some years of experience in production-distribution setups. Many of the basic provisions in the form of production-distribution agreement used in 1945, and indeed being currently used, were formulated in the Legal Department of the New York office of WBPI, and to a great extent agreements prepared out here subsequently have more or less followed that form. Particularly is that so with respect to provisions concerning distribution of motion pictures, since the distribution headquarters is in New York City and the Legal Department there has had considerable contact with distribution matters.

At the time the basic agreement was prepared Herbert Freston had before him a copy of the old agreement drawn in this office between WBPI and

Defendants' Exhibit J—(Continued)

Frank Capra Productions, which latter agreement was not particularly helpful, but [1050] Herbert Freston also had before him a form of production-distribution agreement, in draft form only, prepared by R. J. Obringer in the Legal Department at the Studio. This was an early draft of a proposed production - distribution agreement between WBPI and Michael Curtiz Productions, which agreement, by the way, had not been placed in final form and had not been executed when the preparation of the basic agreement was commenced. The Michael Curtiz preliminary draft was never executed, but other drafts of that agreement were made and one of the drafts formulated by Mr. Obringer was finally signed by Michael Curtiz Productions and by WBPI, according to recollection, in 1946, and perhaps a year after the basic agreement was prepared. However, the Curtiz draft embodied many provisions which seemed to lend themselves to the arrangement between WBPI and USPI and, therefore, considerable recourse was had to that agreement. Accordingly, the Curtiz draft has been reexamined in connection with the basic agreement and its provisions, and in connection with the interrogatories of October 28, 1952, and a number of the answers given to certain of said interrogatories. This memorandum will endeavor to show what provisions in the basic agreement were taken from or based upon the Curtiz draft, and what provisions, found in the basic agreement, [1051] were drafted by Herbert Freston personally.

Defendants' Exhibit J—(Continued)

We will start with paragraph Second of the basic agreement:

Paragraph Second

The first 21 lines of paragraph Second of the basic agreement were taken from paragraph 5 of the Curtiz dr[illegible]t prepared by Obringer.

The last four lines of the first paragraph of paragraph Second of the basic agreement were also taken from the Curtiz draft with slight variations.

The next full paragraph of paragraph Second, commencing with the words "The Company shall keep a record of the cost of all facilities," and ending with the words "the photoplays herein referred to," was drafted by Herbert Freston in his own handwriting when revising the first draft of the basic agreement. (See this handwritten draft in File No. 18465).

The next paragraph of paragraph Second, page 4 of the basic agreement, beginning with the words "The Company shall contribute" and ending with the words "production of a picture," on page 5 of the basic agreement, was taken from a letter from Oliver Schwab dated August 28, 1945, to Herbert Freston, since at a previous conference between Herbert Freston and Schwab it was agreed that he would draft that clause. (See Schwab letter in H.F. [1052] File No. 18465).

The last seven lines of this same paragraph, on page 5 of the basic agreement, beginning with the words "provided, however, in any event," and ending with the words "paragraph Seventh hereof,"

Defendants' Exhibit J—(Continued)

were drafted by Herbert Freston in his own handwriting, and this handwritten draft is attached to the Schwab letter of August 28, 1945, in File No. 18465.

The next paragraph of paragraph Second, page 5 of the basic agreement, commencing with the words "The Company shall bill the Producer weekly," and ending with the words "as hereinafter provided for," was drafted by Herbert Freston in his own handwriting and this draft so written will be found in H. F. File No. 18465.

The last paragraph on page 5 of the basic agreement was also drafted by H. F. in his own handwriting and typing. (See work sheets in File No. 18465).

The first full paragraph at the top of page 6, down to the 13th line from the top, commencing with the words "one-half thereof," was also drafted by Herbert Freston in his own handwriting, for which see draft in File No. 18565.

(The above provision is referred to by Interrogatory 5—see page 62 of Answers to Interrogatories.) [1053]

The next five lines of this paragraph, beginning with the words "provided, however," and ending with the words "amount so paid," were drafted by Herbert Freston and appear in H. F. handwriting on page 5 of H. F.'s second draft of basic agreement, which in turn was based on suggestions made by Obringer to Herbert Freston.

Defendants' Exhibit J—(Continued)

(See Interrogatory 47 of Answers to Interrogatories, pages 63-64.)

The next 8 lines in this paragraph commencing with the words "where the Producer" and ending with the words "such moneys become payable" drafted by Herbert Freston. (See draft in H. F. handwriting in File No. 18465.)

Last 3 lines of this paragraph on page 6 of the basic agreement, commencing with the words "but only for" and ending with the words "being produced hereunder" were inserted by H. F. because of a suggestion made by Obringer, and draft of these 3 lines in handwriting of H. F. appears on page 5 of H. F.'s second draft in File No. 18465.

(See Interrogatory 49 and answers appearing on page 65 of Answers to Interrogatories.)

The last 2 lines on page 6, and the first 7 lines [1054] on page 7 of the basic agreement are based in part on Schwab letter to Herbert Freston of 8-28-45. These lines drafted by Herbert Freston. (See rider attached to page 5, H. F. second draft —File No. 18465).

Second paragraph on page 7 of basic agreement, commencing with the words "The Company agrees" and ending with the words "as such employer" drafted by Herbert Freston in own handwriting. (See this draft annexed to first draft of agreement in File No. 18465).

Paragraph Third

The first full paragraph of paragraph Third,

Defendants' Exhibit J—(Continued)

page 7, drafted by Herbert Freston. (See H. F. handwritten draft re first draft in File No. 18465).

Second paragraph of paragraph Third, appearing on pages 7 and 8 of the basic agreement, ending with the words "its own photoplays" also drafted by Herbert Freston in handwriting, and is in File No. 18465.

Paragraph Fourth

The first 10 lines on page 8 of the basic agreement were drafted by Herbert Freston and were based on paragraph 3 of the Memorandum dated August 17, 1945, dictated by Oliver Schwab and handed H. F. by Bernhard. This Memorandum of 8-17-45 will be hereinafter referred to as the "Bernhard Memorandum." For this draft by H. F., see Paragraph Fourth of H. F.'s [1055] first draft in File 18465.

The next 15 lines of paragraph Fourth, pages 8 and 9 of basic agreement, commencing with the words "final budget" and ending with the words "of the Producer" were based on changes made by Herbert Freston in budget provisions appearing in first draft following a conference between H. F. and Schwab on August 27, 1945. The change in budget provision as requested by Schwab was referred to J. L. Warner for his approval. (See H.F. notes on yellow sheet in H.F. handwriting dated "8-25-45—O.B.S. and H.F.—re submission of budget changes to J. L. Warner."

The paragraph commencing on page 9 of the basic agreement, beginning with the words "since the

Defendants' Exhibit J—(Continued)

photoplays herein provided" and down to the sixth line from the top of page 10 ending with the words "provisions of this paragraph," drafted by Herbert Freston. (See H.F. yellow sheet covering this paragraph in connection with preparation of first draft).

The last 13 lines of paragraph Fourth on page 10 of the basic agreement were drafted by Herbert Freston. (See handwritten draft annexed to and following end of typed part of paragraph Fourth as shown in H. F.'s second draft in File 18465).

Paragraph Fifth

There is nothing of any moment in this paragraph found on page 10 of the basic agreement.

Paragraph Sixth

The whole of paragraph Sixth, page 10, down to and including the seventh line from the top of page 12 of the basic agreement, to and including the word "proper," was substantially taken from paragraph 13 of the Curtiz draft.

The seventh line from the top of page 12 of the basic agreement commencing with the word "provided," and the material included in the next six lines and ending with the words "individual contracts" drafted by Herbert Freston in own handwriting as a result of an agreement reached at a conference between H.F. and Schwab. (See H.F. handwritten memo in File 18465, listing points agreed on in H.F.-Schwab conference).

The last 8 lines of the first paragraph on page 12

Defendants' Exhibit J—(Continued)

of the basic agreement beginning with the words "The Company agrees" and ending with the words "the same party" are taken from paragraph 18 of the Curtiz draft.

The first 12 lines of the second paragraph on page 12 are, with minor variations, taken from paragraph 13 of the Curtiz draft. [1057]

The material on page 13, basic agreement, third line from the top of that page, commencing with the words "provided, however," to and including the words "of the Producer" in the sixth line from the bottom of paragraph Sixth, page 12, was drafted by Herbert Freston pursuant to paragraph 14 of the Bernhard Memorandum. (See H.F. handwritten draft of this provision attached to end of paragraph Sixth in H.F. first draft, File 18465.)

The last 6 lines of paragraph Sixth, page 12 of the basic agreement were taken from the last 7 lines of paragraph 13 of the Curtiz draft.

Paragraph Seventh

Paragraph Seventh of the basic agreement was taken from paragraph 12(a) of the Curtiz draft, with the exception of sub-paragraph 4½ appearing on page 15 and 16 of the basic agreement, and with the exception of the words "except the moneys set forth in subdivision 4½ of this paragraph, which moneys the Company shall pay or cause to be paid to the Producer," which appeared in the last two lines on page 13 and in the first line on page 14 of the basic agreement. Also excepting the refer-

Defendants' Exhibit J—(Continued)

ence to sub-paragraph 4½ in the sixth line from the top of page 14.

(Interrogatory 51, shown in the Answers [1058] to Interrogatories on page 66 is directed to this subparagraph 4½ found on page 15 and 16 of the basic contract.)

Subparagraph 4½ was drafted by Herbert Freston and was based upon paragraph 19-D and paragraph 20 of the Bernhard Memorandum. Paragraphs 19-D and 20 of the Bernhard Memorandum presumably were incorporated in that memorandum by Schwab at the direction of Bernhard as being one of the items that H. M. Warner and Bernhard agreed upon while they were discussing certain provisions which would be included in the basic agreement. H. F. did not raise any question as to whether or not such a provision was agreed upon between Messrs. Warner and Bernhard, but simply drafted clause 4½ of paragraph Seventh (a) because, so far as H. F. was concerned, it was one of the things that Warner and Bernhard had agreed to be incorporated in the basic agreement. (See draft of Section 4½ of paragraph Seventh (a) is in H. F.'s handwriting. See yellow memorandum in file marked "H.F." in file 18465.

Practically all of the provisions of paragraph Seventh (a), including subparagraphs (1) to (1) inclusive, but omitting subparagraph 4½, are more or less standard provisions appearing in the form of distribution contract in common use by WBPI, and, as [1059] above noted, these standard provi-

Defendants' Exhibit J—(Continued)

sions were included in the Curtiz draft from which Seventh (a) largely was taken.

As above noted, Interrogatory 51, found on page 66 of the Answers to interrogatories, quotes paragraph 4½. Interrogatory 52, on page 66 of the Answers to Interrogatories, asks the question whether any such contract or contracts other than the WBPI-USPI basic agreement, entered into by Warner Bros., contained any provision substantially like or similar to the above-quoted Section 4½.

H. F. knows of no other contract, as finally executed by Warner Bros., which contained a clause similar to Section 4½. However, it should be noted that the Curtiz draft prepared some time in 1945, which H. F. had before him when preparing the basic agreement, in paragraph 14 (a), (IV), page 16, states:

"It is agreed, however, that the actual allocation of general overhead as herein concerned, shall be as determined by Price, Waterhouse & Co., certified Public Accountants, as the proper and fair charge to each photoplay, and shall be no greater than said Price, Waterhouse & Co. determines should be charged to other photoplays produced by Warner of similar type and [1060] comparable cost and importance."

It should also be noted that this clause was taken from an early draft of the Curtiz contract, but when the Curtiz contract was finally executed by WBPI and by Curtiz Productions, that clause was

Defendants' Exhibit J—(Continued)

eliminated and a flat 35 per cent overhead rate was inserted instead.

It should also be noted that paragraph 14(a) (IV) of the Curtiz contract provides: The production cost shall further include the general overhead of the Producer as herein defined."

In another part of the contract, the Producer's overhead production costs were fixed at $10,000 for each picture to be produced by Curtiz under the contract.

The obvious conclusion is that when the final Curtiz contract was negotiated, prior to execution the parties thereto could not agree upon the Price, Waterhouse provision and for that reason a flat overhead rate was provided for.

The last 9 lines of paragraph Seventh (a) found on page 17 of the basic agreement, relating to the Pierce, Waterhouse determination as to what the overhead should be, were drafted by H. F. in own handwriting. See this draft following paragraph Seventh (10) attached to the first draft in File 18465.

Subparagraph (b) of paragraph Seventh, page 18 of basic agreement, was copied from paragraph 14(b) of the Curtiz draft and appears on page 18 of that draft.

Paragraph Seventh (c), pages 18 and 19 of the basic agreement was copied from paragraph 14(c) of the Curtiz draft on pages 18 and 19 thereof.

Paragraph Seventh (d), pages 19 and 20 of basic

Defendants' Exhibit J—(Continued)

agreement was taken from paragraph 14(d); pages 19 and 20 of the Curtiz draft.

Paragraph Seventh (e), pages 20-21 of basic agreement was taken from paragraph 14(e), pages 20-21 of the Curtiz draft.

Paragraphs Seventh (f), (g), (h) and (i), pages 21 to 23 of the basic agreement were taken from paragraphs 14 (f), (g), (h) and (8), pages 21 to 23 of the Curtiz draft.

Paragraph Seventh (j) of the basic agreement was taken from paragraph 14(j) of the Curtiz draft, pages 23 and 24, with slight variations.

The first 13 lines of Seventh (k), pages 24 and 25 of the basic agreement were based upon paragraph 14 (k) of the Curtiz draft, page 25.

The material in paragraph Seventh (k), pages 25-26 of the basic agreement, commencing with the [1062] words "The Producer furthermore" in the tenth line from the top of page 25 of the basic agreement, to and including the words "commence thereon" on page 26 of the basic agreement, was drafted by Herbert Freston. (See notes of H.F. on this item on pages 23 and 24 of the second draft in File 18465).

Paragraph Eighth

The whole of paragraph Eighth, pages 26-28 of the basic agreement was taken from paragraph 15, pages 24-26 of the Curtiz draft.

Paragraph Ninth

That part of paragraph Ninth, page 28 of the

Defendants' Exhibit J—(Continued)

basic agreement from the beginning thereof down to and including the words "during such period" in the 13th line from the top of page 29 of the basic agreement, was taken from paragraph 17 of the Curtiz draft.

The last 11 lines of paragraph Ninth, page 29 of the basic agreement were drafted by Herbert Freston. (See H.F. handwritten draft pasted on page 27 of the first draft in File 18465.)

Paragraph Tenth

Paragraph Tenth, page 29 of the basic agreement, down to and including (c) on page 30 of the basic agreement was taken from and in large part based upon paragraph 18 of the Curtiz draft. (See H.F. [1063] notes on this on pages 29-30 of the first draft.)

The last 4 lines on page 30 of the basic agreement, down to the middle of page 31, ending with the words "as the case may be" were drafted by Herbert Freston in own handwriting. (See handwritten draft attached to page 29 of second draft in File 18465.)

Paragraph Eleventh

Paragraph Eleventh, pages 31-2 of the basic agreement, taken in part from paragraph 19, page 32 of the Curtiz draft.

Paragraph Twelfth

Paragraph Twelfth, page 32 of the basic agreement was taken from paragraph 20, pages 32-3 of

Defendants' Exhibit J—(Continued)

the Curtiz draft, except the last line of paragraph Twelfth, reading: "and to release any such picture as a photoplay of the Company." This quoted line was added by Herbert Freston. (See first draft for that addition in H.F. handwriting on page 31 of first draft.) [1064]

Paragraph Thirteenth

Paragraph Thirteenth for the most part, with slight variations, was taken from paragraph 21, pages 33 and 34 of the Curtiz draft.

The middle paragraph on page 33 of the basic agreement was taken from paragraph 21, page 34, of the Curtiz draft, but changed in accordance with the requirements of paragraph 4 of the Bernhard Memorandum.

The last paragraph commencing on page 33 of the basic agreement, with the words "The Producer understands," and ending with the words "with the Company" on page 34 of the basic agreement, was drafted by Herbert Freston in own handwriting. (See handwritten draft affixed to page 33 of the first draft in File 18465.)

The last 2 paragraphs of paragraph Thirteenth on page 34 of the basic agreement were taken from the Curtiz draft, paragraph 21, page 34.

Paragraph Fourteenth

The paragraph Fourteenth originally drafted by Herbert Freston on pages 34 and 35 of the basic agreement was eliminated from the contract and a

Defendants' Exhibit J—(Continued)

new paragraph Fourteenth was made a part of the contract in lieu thereof. This new paragraph Fourteenth apparently was drafted by Mr. Obringer and was signed by him on behalf of WBPI and by USPI, is in letter form, and is dated November 7, 1945. [1065] When the basic agreement was recopied as a whole, in New York, the revised paragraph Fourteenth was copied in as a part of the basic contract and for that reason it appears in the photostatic copy as if it had originally been inserted therein in its present form in the first instance.

Paragraph Fifteenth

The first paragraph of paragraph Fifteenth of the basic agreement was drafted by Herbert Freston in his own handwriting. The first 13 lines of paragraph Fifteenth, in H.F. handwriting, are attached to paragraph Fifteenth of the second draft.

The remainder of said first paragraph commencing with the words "since the production of the photoplays" and down to and including the words "contracts or agreements" were also drafted by H.F. in his own handwriting, for which see handwritten draft attached to page 38 of the first draft in File 18465.

The last paragraph of paragraph Fifteenth appearing on page 35 of the basic agreement was also dictated and in part redrafted by Herbert Freston in his own handwriting. (See pages 34 of second draft.) The above provisions drafted by H.F. were in turn based upon certain provisions, changed

Defendants' Exhibit J—(Continued)

somewhat, appearing in paragraph 25, pages 38 and 39 of the Curtiz draft. [1066]

Paragraph Sixteenth

This paragraph, with certain modifications, was based upon paragraph 26, page 39, of the Curtiz draft.

Paragraph Seventeenth

Paragraph Seventeenth of the basic agreement, pages 35 and 36, was based in part on paragraph 27, pages 39 and 40, of the Curtiz draft.

Paragraph Eighteenth

Paragraph Eighteenth of the basic agreement was in large part taken from paragraph 28, page 40, of the Curtiz draft.

Paragraph Nineteenth

Paragraph Nineteenth, pages 36-37, of the basic agreement was taken in part from paragraph 29, pages 40-41 of the Curtiz draft.

Paragraph Twentieth

Paragraph Twentieth of the basic agreement was substantially taken from and is based upon paragraph 30, pages 41 and 42 of the Curtiz draft.

Paragraph Twenty-First

Paragraph Twenty-first of the basic agreement was taken from paragraph 31, page 42 of the Curtiz draft.

Paragraph Twenty-Second

Paragraph Twenty-second of the basic agreement

Defendants' Exhibit J—(Continued)

was taken from paragraph 32, page 42, of the Curtiz draft. [1067]

Paragraph Twenty-Third

Paragraph Twenty-third of the basic agreement was taken from paragraph 33, page 42, of the Curtiz draft.

Paragraph Twenty-Fourth

Paragraph Twenty-fourth, page 39 of the basic agreement, was taken from paragraph 34, pages 42 and 43 of the Curtiz draft.

Paragraph Twenty-Fifth

Paragraph Twenty-fifth of the basic agreement was taken from paragraph 36, page 44 of the Curtiz draft.

Paragraph Twenty-Sixth

Paragraph Twenty-sixth of the basic agreement was taken from paragraph 37, page 44, of the Curtiz draft.

Paragraph Twenty-Seventh

The first full paragraph of Paragraph Twenty-Seventh, page 40 of the basic agreement was taken from or based upon paragraph 39, page 46 of the Curtiz draft.

The second paragraph of paragraph Twenty-Seventh relating to notices which the Producer may desire to give the Company was drafted by Herbert Freston and this clause appears in both the first and second drafts of the basic agreement in File 18465.

Defendants' Exhibit J—(Continued)

Paragraph Twenty-Eighth

Paragraph Twenty-eighth, page 41 of the basic agreement was in part based upon paragraph 40, page 46 of the Curtiz [1068] draft.

Paragraph Twenty-Ninth

Paragraph Twenty-ninth, pages 41 and 42 of the basic agreement was taken from paragraph 41, pages 46 and 47 of the Curtiz draft.

Paragraph Thirtieth

Paragraph Thirtieth of the basic agreement from the beginning thereof on page 42 to and including the words "distribution charges" on page 43, was taken in part from and was based upon paragraph 42, page 47 of the Curtiz draft.

The last paragraph of paragraph Thirtieth of the basic agreement, page 43, commencing with the words "if either the Company" and ending with the words "action or proceeding" was drafted by Schwab as a result of the conference between H.F. and Schwab held on October 27, 1945, and the material in said paragraph appears on pages 1 and 2 of Mr. Schwab's letter to H. F. dated August 28, 1945, in file 18465.

Paragraph Thirty-First

The first and second drafts of the basic agreement were prepared by Herbert Freston before he was advised that USPI intended to procure a loan from a bank from the purpose of financing its 50

Defendants' Exhibit J—(Continued)

per cent of the production costs of each picture. Theretofore H.F. had assumed, without knowing, that USPI would provide its own production costs. [1069] For instance, paragraph 9 of the Bernhard Memorandum states:

"Fifty per cent or such lesser sum as U.S. Pictures may require of the total negative costs of each of the pictures is to be lent by Warner Bros. to U.S. Pictures. The balance of production funds to be provided by U.S. Pictures."

However, when the second draft of the contract was completed, in draft form for the purpose of submitting the draft to Mr. Bernhard and Mr. Schwab, H.F. was advised that arrangements have been made by Mr. Bernhard to borrow USPI's share of the production costs from a New York bank. Accordingly, after the second yellow paper draft had been completed in full, H.F. drafted a new paragraph and numbered it "Thirty-first." This required the remaining paragraphs of the second yellow paper draft, from paragraph Thirty-second to Thirty-fifth, to be renumbered. Thus, paragraph Thirty-second became paragraph Thirty-third, and so on, ending the second draft with paragraph Thirty-sixth. Therefore, paragraph Thirty-first was drafted by Herbert Freston, and certain changes were made in said draft in the handwriting of Herbert Freston as shown on the draft of paragraph Thirty-first in the yellow paper second draft of the basic agreement in File 18465.

Said draft of paragraph Thirty-first, as [1070]

Defendants' Exhibit J—(Continued)

prepared by Herbert Freston, was incorporated in the final basic agreement as paragraph Thirty-first.

On November 8, 1945, long after H.F.'s work on the basic agreement was completed, he received a letter dated November 6, 1945, from Stanleigh P. Friedman, New York. In that letter Mr. Friedman told H.F. that Friedman had closed a loan for USPI from the New York Trust Company for the purpose of supplying USPI's share of the production costs. In the course of his letter to H.F., Mr. Friedman stated:

"In the course of agreeing upon the language of the various documents required, it seemed advisable for us to change the language of Section Thirty-first of the Basic Agreement. That clause of Section Thirty-first in which Warner Bros. agrees to subordinate its claim for cash and facilities advanced by it to the bank's claim for priority in the repayment of moneys advanced by the bank, seemed to us to come very close to contravening the inhibition in the Warner $37,000,000 bank loan agreement. The reasoning is as follows:

"The Warner bank loan agreement (2) (a) provides that Warner will not permit a [1071] lien or encumbrance upon any account receivable; to subordinate its account receivable from United States Pictures to the prior payment of the Bank's loan is almost equivalent to permitting an encumbrance upon Warner's account receivable. In view of the foregoing, United States Pictures, with the consent of The New York Trust Company, entered

Defendants' Exhibit J—(Continued)

into a Letter Agreement of November 2, 1945, amending the Basic Agreement of September 28, 1945 (this is the new date of this agreement) a copy of which is enclosed herewith. The Letter Agreement revises the language of the one paragraph in Section Thirty-first so as to make it benign in the light of the $37,000,000 bank loan agreement.

"In order that you may guide yourself as to the inhibitory clauses of the bank loan agreement, I am enclosing herewith a copy for your files."

The Letter Agreement referred to by Mr. Friedman in his letter amended paragraph Thirty-first of the basic agreement as prepared by H. F., said Letter Agreement being as follows:

"November 2, 1945. [1072]

"Warner Bros. Pictures, Inc.,
New York, N.Y.

Dear Sirs:

Referring to the agreement between us dated September 28, 1945, it is agreed that the next to the last paragraph of paragraph Thirty-first shall be amended to read as follows:

'If said bank loan shall be made, as aforesaid, in connection with any photoplay, then in order that said bank may be reimbursed for the amount of its loan, principal and interest, in accordance with the foregoing, the Company agrees that the Producer or its assignee will be entitled to receive all of the gross receipts of such photoplay less distribution

Defendants' Exhibit J—(Continued)

fees and expenses until Producer or its assignee has received the amount of the bank loan with interest thereon pertaining to such photoplay and the Company agrees that until such time it will pay such balance of the gross receipts of the bank in liquidation of such loan. The distribution fees and expenses which shall be deducted as just set forth shall be those specified in subdivisions (1), (2), (3), (5), (6), (7) and (8) [1073] of said paragraph Seventh (a) and as set forth in subdivision (a) to (e) inclusive of paragraph Seventeenth hereof.'

Very truly yours,

United States Pictures, Inc.
By Jos. Bernhard, President

Agreed to: Warner Bros. Pictures, Inc. By Stanleigh P. Friedman, Vice-President.

Consented to: The New York Trust Company, By Willis McDonald, Vice-President."

At the time H. F. prepared paragraph Thirty-first of the basic agreement he did not know of the loan agreement which WBPI had with the New York banks and, of course, not having seen the agreement, he did not know that there was any provision in that agreement prohibiting Warner Bros. from placing any lien or encumbrance upon any of its accounts receivable or of subordinating its accounts receivable until the New York bank had been repaid the amount of its loan. Had he

Defendants' Exhibit J—(Continued)

known that at the time, H.F. would, of course, not have prepared paragraph Thirty-first in the manner he did. In any event, paragraph Thirty-first was amended in New York as shown above, and this eliminated any possible violation of the Warner Loan Agreement with the New York bank.

H.F. understands that plaintiff's counsel endeavored to make some point of the fact that paragraph Thirty-first may have contravened the provisions of the Warner Loan Agreement with the New York Bank. H.S. was informed—the source of the information not being presently recalled,—that Messrs. White and Case of New York represented the New York Trust Company in bringing about this amendment to paragraph Thirty-first, and that afterward Messrs. White and Case expressed the opinion that Paragraph Thirty-first of the basic agreement, as amended, did not violate the Warner Loan Agreement with the New York banks.

Paragraph Thirty-Second

Paragraph Thirty-second, page 47 of the basic agreement was drafted by Herbert Freston and was based upon paragraph 21 of the Bernhard Memorandum. Schwab said USPI would like to have the right to do an outside picture so long as it was not in default under the basic agreement. This request was submitted to J. L. Warner by H.F. for approval, and upon his approval being given was written into the final draft. [1075]

Defendants' Exhibit J—(Continued)

Paragraph Thirty-Third

Paragraph Thirty-third, page 47 of the basic agreement was taken from paragraph 44, page 48 of the Curtiz draft.

Paragraph Thirty-Fourth

Paragraph Thirty-fourth, page 47 of the basic agreement was taken from paragraph 45, page 48 of the Curtiz draft.

Paragraph Thirty-Fifth

Paragraph Thirty-fifth of the basic agreement, page 47, was taken from paragraph 46, page 48 of the Curtiz draft.

Paragraph Thirty-Sixth

Paragraph Thirty-sixth of the basic agreement was inserted in the agreement in New York when the basic agreement was rewritten. This paragraph simply made the agreement effective on and after November 7, 1945.

Paragraph Thirty-Seventh

Paragraph Thirty-seventh, pages 47 and 48 of the basic agreement—which was paragraph Thirty-sixth in H. F.'s final draft—was based upon paragraph 47, page 48, of the Curtiz draft.

Schedule A to the contract was simply copied from a form submitted by the New York office, which same form was annexed to the Curtiz draft as Exhibit B. This was a standard schedule supplied by counsel of the office of [1076] distributor in New York.

Exhibit or Schedule B to the basic contract was

Defendants' Exhibit J—(Continued)

the letter from Price, Waterhouse & Co. establishing the overhead charge to USPI for the furnishing by WPBI of production facilities.

H.F. does not recall ever seeing the Price, Waterhouse letter, Schedule B to the basic agreement, until after the contract was fully prepared by H.F. in final form.

On page 17 of the basic agreement, H.F. simply included a provision in his own handwriting to the effect that the Price, Waterhouse letter should be attached to the agreement as Schedule B. [1077]

* * * * *

Q. Now, we will then proceed to another subject. Having completed what you regarded as the final draft of what is now Exhibit No. 1, what did you next do with that draft?

A. Well, in the interim I had several more conferences, I think with one of the Warners or perhaps both of them, I think perhaps with Mr. Schwab, perhaps with Mr. Bernhard. I have notes on all of this showing to whom I talked, and when and where. And after the agreement was finally finished in the form that I have it here, referring to Exhibit I for identification, I took that out to the studio, where I had a conference with H. M. and J. L. Warner for about two hours.

Q. And what was the substance of that conference?

A. I went over this agreement from beginning to end with them, both of them. During the course —I did not read it all. Some clauses I read. I ex-

(Testimony of Herbert Freston.)

plained to each of them what the clauses meant, what they said in a general way, and during the course of that explanation both of them asked me a number of questions about it. I endeavored to answer those questions. And that was on the 30th of August, 1945.

Q. Was there any other person present at that time?

A. I don't remember whether there were or not, but my offhand recollection is that both Warners were there, maybe Bernhard was there. I can tell by looking at my documents.

Q. Will you look at your documents and tell me, Mr. Freston, what documents are you now looking at?

A. These are my personal office time sheets covering the time spent by me on all phases of the preparation of this agreement and its explanation to the clients. [1079]

* * * * *

Q. By referring to those will you tell us who were present at these conferences?

A. You mean in the August 30th conference?

Q. Well, whatever the conferences that involved the consideration of this agreement after you got it in draft form.

A. All right. On the 21st of August, which was the day after I completed the first draft of this document, I was enroute to and at the studio from 3:15 until a quarter of 6:00 that night. And at the studio, my notes say—and I verily believe they are

(Testimony of Herbert Freston.)

correct—I talked with H. M. Warner, J. M. Bernhard and Milton Sperling about this agreement and the terms of it.

On the 22nd of August I was engaged in revising that agreement from a quarter of 10:00 in the morning until 11:15 that night.

On the 22nd of August I was again engaged in revising [1080] the agreement.

On the 24th of August I was working on the agreement yet, and on the 24th of August at between 1:30 and 5:00 o'clock I was at the studio for a conference with H. M. Warner, J. L. Warner, Joe Bernhard, Milton Sperling, and Oliver Schwab with reference to this contract.

On the 27th of August from 1:15 to 3:00 o'clock I had a conference in our office with Mr. Oliver Schwab.

Q. That is the conference to which you have already testified?

A. To which I have referred heretofore. Also I see I spent an hour and a half in the morning on that da working on this agreement.

On the 28th of August my record shows I only spent 15 minutes in looking over certain changes in the agreement.

On the 29th of August I worked about three hours on it for some reason or other.

On the 30th day of August from 12:00 to 1:00 o'clock, my notes show reading the agreement, etc., in preparation for a trip to the studio to see J. L. Warner and Joe Bernhard. My notes show also that

(Testimony of Herbert Freston.)

from 1:15 until 4:30 I was enroute to and at the studio for conferences with H. M. Warner, J. L. Warner, Joe Bernhard, Obringer, and Schwab with reference to the agreement. Now, I cannot recall at this time whether Mr. Obringer or Mr. Schwab were there, but nevertheless, it [1081] was my understanding that I was going there to see them.

On the 31st of August, which was the day following the final conference I had at the studio with the brothers Warner, my time sheet shows that I spent 30 minutes only in making changes in my file copy of the agreement, and there was one change that was made in the agreement on August 30th at the final conference I had with the brothers Warner that was more than a mere typographical change.

Q. What was that change?

A. And that was the change of the distribution charge set forth in subdivision (1) of the paragraph Seventh (a) from 15 per cent to 20 per cent. I did not rewrite the contract for the purpose of showing that change in typing, but I merely interlineated above, struck out the word "f-i-f-t-e-e-n", and had my secretary type the word "t-w-e-n-t-y," struck out the figures "15 per cent" and had my secretary insert above that the typewritten numbers "20 per cent." And that is the change—that is one of the changes that were made as the result of the conference with the brothers Warner on the 30th of August, 1945. [1082]

* * * * *

Q. What is the practice of banks with reference

(Testimony of Herbert Freston.)

to the matter of security required and the time and manner of repayment of loans to independent producers? A. It is the normal——

Mr. Levy: Just a moment.

The Witness: Pardon me.

Mr. Levy: I object to the question as to the practice of banks generally. I don't see that it has any relevancy on the issue we are trying here, the practice of banks.

If counsel were to confine the question to bring it right close home, does this situation, namely, the transaction that was involved here between the New York Trust Company and Warner, if the question were directed to what the demands of the New York Trust Company were with respect to this particular transaction, the question would not be objectionable.

The Court: Is the purpose of it to show the witness' understanding at the time he drafted the agreement? [1084]

Mr. Williams: The purpose is to show the witness' understanding at the time he drafted the agreement.

The Court: Why don't you pass the question in that form instead of attempting to prove the fact?

Mr. Williams: I thought I had, if your Honor please; but, in addition to that, I also will want to prove the fact with reference to the practice of banks, because the issue in this case has been raised that this matter of subordinating the Warner Bros.' right to get money to that of the bank was a very

(Testimony of Herbert Freston.)

terrible thing for the benefit of Harry Warner's son-in-law.

It is my purpose to prove there has never been, so far as this witness and many others I am prepared to call, there has never been a case in which a bank ever did lend any money in which it did not require the deposit of the negative and require that this money should come first after the distribution fee and expenses.

In other words, to show that that was a settled practice. [1085]

* * * * *

Q. Do you know, Mr. Freston, whether at the time you drafted what is now Exhibit 1 in this case, whether there was at that time a practice of banks in reference to the security required and the terms of repayment of loans made to independent producers? A. I do.

Q. You were aware of that at that time?

A. I was. [1086]

The Court: Very well. The question is what you understood those requirements to be at the time you drafted Exhibit 1, as I understand it.

The Witness: That is correct. The bank would generally want to see that a proper commitment had been made to distribute the picture. That is one of the first requisites.

The Court: A reliable distributor?

The Witness: A reliable distributor.

The bank then would insist as a condition precedent to its loan that the negative and prints gen-

(Testimony of Herbert Freston.)

erally be pledged or hypothecated for the benefit of securing the bank in the repayment of the amount of its loan with interest.

The Court: Would that include the mortgage of the copyright?

The Witness: I don't recall whether the pledge agreement goes so far as to cover the copyright or not, [1092] but they do do it. We have one in the Capra situation which would show that.

The bank also insists, and this is a very common requirement, that where an independent producer makes a picture on a major lot for major distribution, that there shall be an unconditional guarantee of completion of that picture by the major producer.

The banks also insist that the money payable to the bank or the money coming to the bank in repayment of its loan, principal and interest, shall come out first.

The Court: That is, out of the first proceeds of distribution?

The Witness: That is correct; out of the first proceeds of distribution, with the sole exception only of the distribution costs and things of that sort which enables a distributor to distribute, but the next money goes to the bank until the bank is repaid in full, principal and interest. [1093]

* * * * *

The Court: Do you have any knowledge as to the requirements of New York banks?

The Witness: I have no knowledge as to the

(Testimony of Herbert Freston.)

[1094] requirements of New York banks except the knowledge that I have obtained from this very deal, I might say to your Honor. [1095]

* * * * *

Q. (By Mr. Williams): Mr. Freston, at the time you drew this agreement, Exhibit 1, without going into any specific details, did you have the intention at that time of making an agreement which would be especially for the benefit of Mr. Sperling, and to the same extent unfair to Warner Bros. Pictures, Inc.? [1099]

* * * * *

A. It was my intention to draw an agreement that was perfectly fair to my own client as well as to United States Pictures. In paragraph 31 I simply made out the common program that has been used in banking loans for many years. It doesn't favor one or the other. The bank is the only one that is favored, really.

* * * * *

Q. (By Mr. Williams): The question I asked, which I think probably I did not make clear enough, I was referring to paragraph 31 specifically, and I was referring to the entire agreement, Exhibit 1 in this case, and I ask you whether at the time you were drafting this agreement you had the intention to draft an agreement which [1100] would specially favor Mr. Sperling or United States Pictures, or either of them, and to the same extent would be detrimental to Warner Bros. Pictures, Inc.?

(Testimony of Herbert Freston.)

A. I had no such intention, Mr. Williams.

* * * * *

Q. Was it your intention in drafting this agreement, and in the drafting of it, to make an agreement which would fairly protect the interests and safeguard the rights of Warner Bros. Pictures, Inc.? A. That was my intention. [1101]

* * * * *

Q. Did any person who discussed the matter of this agreement with you while you were drafting it or at any time in connection with the drafting of it make any statement to you which you understood to be a request or suggestion that you should unduly favor United States Pictures or Milton Sperling to the detriment of Warner Bros. in connection with this deal?

A. Nobody made any such statement, Mr. Williams, at any time.

I might say to you this agreement is largely my own idea. [1103] I put it the way I thought it should be. [1104]

* * * * *

Q. (By Mr. Williams): Was there any act, verbal or otherwise, or anything done or said by any person in connection with this matter, which you understood to be a request or an intention or a suggestion that you should favor Milton Sperling to any extent, or United States Pictures to any extent, in the matter of drafting this agreement?

A. Nothing was said by anybody on any phase of any such situation at any time.

(Testimony of Herbert Freston.)

The Court: Do you mean that your answer is "No"?

The Witness: I mean that my answer is "No," your Honor. I find it difficult to explain this, but, as a matter [1105] of fact, I constructed this agreement myself. Nobody told me what to put in it——

* * * * *

Q. (By Mr. Williams): Mr. Freston, what information did you have during the time you were drafting this contract as to what, if anything, had been decided by anybody with reference to the salaries of Milton Sperling and Joseph Bernhard?

A. I was told what they were by H. M. Warner.

Q. And what were you told?

A. I was told they were to be $1,000 a week, which he had approved.

The Court: Did you understand that to mean that Sperling—and who is the other man?

The Witness: Bernhard. [1111]

The Court: ——and Bernhard had agreed between them that they would have a salary each of $1,000 a week, and that H. M. Warner had approved that arrangement?

The Witness: That is what I understood, that it was an approval all around, that it was an agreement all around that their salaries would be that amount.

Mr. Levy: May we have the date of that discussion?

The Witness: Well, Mr. Levy, it is somewhere between August 21 and August 30 of 1945.

(Testimony of Herbert Freston.)

Mr. Levy: Yes, sir.

Q. (By Mr. Williams): And was it at one of these conversations that you have already testified that you had with H. M. Warner?

A. Yes. [1112]

* * * * *

The Court: It calls for "belief." Sustained. Do you mean to inquire whether, according to this witness' understanding at the time he drafted Exhibit 1, it was anything unusual for a company such as Warner Bros. to enter into such an arrangement as this with an independent producer of such limited capital?

Mr. Williams: Yes.

The Court: Is there objection to the question in that form?

Mr. Levy: If the question is asked in that form, I have no objection to it.

Mr. Williams: May I adopt that question as my question, your Honor?

The Court: You may if the witness understands it.

The Witness: Would you read it, please, Mr. Bargion?

(Question read by the reporter.) [1116]

A. It was not unusual, your Honor. It was the customary thing.

The Court: That was your understanding at the time?

The Witness: That was my understanding and it always has been. * * * * * [1117]

STANLEIGH P. FRIEDMAN

called as a witness on behalf of defendants, having been duly sworn, testified as follows:

The Clerk: Will you state your name to the court?

The Witness: Stanleigh P. Friedman, S-t-a-n-l-e-i-g-h P. F-r-i-e-d-m-a-n.

The Clerk: Your address?

The Witness: 321 West 44th Street, New York City, New York.

Direct Examination

Q. (By Mr. Williams): Mr. Friedman, what is your occupation? A. I am a lawyer.

Q. How long have you been a lawyer?

A. I was admitted to the bar of New York in 1907.

Q. Have you been practicing in New York since that time?

A. No; I graduated from Harvard Law School and have practiced continuously from then until the present time. [1125]

Q. Your offices are in New York City?

A. Correct.

Q. To what courts are you admitted to practice?

A. The United States Supreme Court, the courts of New York, the United States District Court, the Circuit Court of Appeals for the Second Circuit, and your Ninth Circuit Court of Appeals.

Mr. Williams: I wanted to bring out the Ninth Circuit Court of Appeals, your Honor, so that he is not completely a foreigner. I think, if I may, I

(Testimony of Stanleigh P. Friedman.)

ought to, in fixing the qualifications of this witness, call attention to the fact that he is the author of the famous Downfield, the fighting son of Yale University, and three others of the athletic songs regularly played. I am sure that will assist the court in appraising his qualifications.

The Witness: A good musician among lawyers and a good lawyer among musicians.

Q. Mr. Friedman, you are one of the attorneys for Warner Bros. Pictures, Inc.? A. Yes.

Q. How long have you been an attorney for that corporation?

A. Since its inception in April, 1923.

Q. As a matter of fact, you organized the corporation, did you not, you and your partners?

A. My firm, Thomas & Friedman.

Q. Are you a director of Warner Bros.?

A. Yes, sir.

Q. How long have you been a director of Warner Bros.? A. 1930 to date.

Q. In addition to that, do you occupy any office in the company? A. I am vice president.

Q. How long have you been a vice president of Warner Bros.?

A. 1935 or 1936. Since 1935 or 1936.

Q. Where do you make your headquarters with reference to the offices of the company?

A. 321 West 44th Street, New York City.

Q. That is in the same building?

A. In the Warner Building.

(Testimony of Stanleigh P. Friedman.)

Q. Do you devote substantially all of your time to the affairs of Warner Bros. Pictures, Inc.?

A. Yes.

Q. In addition to yourself, what are the other lawyers in New York who represent the company?

A. Our general counsel is Robert W. Perkins. We have six or seven other members of the legal department.

Q. What particular branch of the work do you specialize in? [1127]

A. I have charge of all taxes, federal, state and city and foreign taxes. I have reasonable charge of the litigating department on litigated matters, with the exception of antitrust matters. I have much to do with all the banking arrangements which Warners have had with various banks since the inception of the company. I have much to do with SEC, the Securities and Exchange Commission transactions, and with other corporate activities as such.

Q. In the normal course of your business, do you yourself have anything to do with the drafting or the passing on of contracts of independent producers with Warner Bros. Pictures?

A. No.

Q. Who in Warner Bros. usually takes care of that?

A. Mr. Bareford; Harold Bareford; who, with Mr. Perkins have most to do with these contracts of distribution, and I might add Mr. Ebenstein; contracts where there are independent producers or

(Testimony of Stanleigh P. Friedman.)

in which actors have a share of the profits, but it is beyond the general ambit of my duties.

Q. In the fall of 1945, that is, in the months of August and September, was Mr. Bareford available at the New York offices?

A. No; Mr. Bareford was in the service of his country. [1128]

Q. During that period did you receive from the Burbank Studios a draft of a contract between United States Pictures and Warner Bros. Pictures, Inc.? A. I did.

Q. You are familiar with the document which has been marked as Plaintiff's Exhibit 1 in this case, are you not? A. Yes.

Q. Was the document which you received at that time substantially what that Plaintiff's Exhibit 1 now is? A. Yes.

Q. At the time you received it, what did you do with it?

A. I personally made a thorough analysis of it, which was so long that my friends made fun of me because the analysis was almost as long as the contract itself.

Q. In other words, you made a written analysis?

A. I made a written analysis of every paragraph.

Q. In the course of going over that contract, did you arrange for any changes to be made in it, or suggest any changes in it?

A. I did, a couple of changes, after talking it over with Mr. Perkins and having checked on it

(Testimony of Stanleigh P. Friedman.)

in other ways. I made some minor corrections, and one of them is the correction that Mr. Freston adverted to about the paragraph, I think it is the one toward the end where the [1129] contract was not to begin its operation until November 7, 1945.

I also made a change in the paragraph having to do with the production of pictures outside the studio, for outside distribution, and I think the original contract shows interlineation in my handwriting, but it is entirely inconsequential.

Q. Was the contract then typed up for signature in New York? A. It was.

Q. In connection with going over this contract, did you discuss the contract or its terms with any of the other people then at Warner in New York?

A. I discussed it with Mr. Perkins. I discussed it with Mr. Schneider, who was then at the coast, by long distance telephone.

Q. Do you remember what phase or phases of the contract you discussed with Mr. Schneider?

A. I asked about certain questions with which I was somewhat unfamiliar, namely, the amount of distribution expense, distribution allowance, particularly, and my memory doesn't serve me accurately as to whether there were any other matters in that contract, any other paragraphs or provisions in that contract as to which I had any doubt, but I did have some doubt about that provision, [1130] because I was unfamiliar with the terms for distribution allowance.

(Testimony of Stanleigh P. Friedman.)

Q. Do you remember the substance of the conversation you had with Mr. Schneider?

A. Yes. I vaguely remember that I asked him if 20 per cent was the usual allowance. I had heard of another contract where the distribution allowance was 17½ per cent and I had thought that perhaps this was a little high. I wanted to make sure that it was correct.

I was told by Mr. Schneider that it was.

Q. Did you discuss the terms of the contract with anybody else that you now remember besides Mr. Schneider and Mr. Perkins?

A. Yes, I had a telephone conversation with Mr. Freston about it, but I have forgotten on what subject.

Q. You don't remember, then, having discussed it with anybody besides these three men you have mentioned at that time?

A. I discussed it with Major Albert Warner in order to acquaint him with some of the details of the contract, because he was the one to present it at the meeting of the board of directors where it was to be submitted for consideration.

Q. Were you present at the meeting when the contract [1131] was submitted for consideration?

A. Yes.

Q. What happened at that meeting, so far as this contract is concerned?

A. Mr. Warner, Albert Warner, who presided at the meeting, and usually presides at the meetings in New York, stated at that time, at the time

(Testimony of Stanleigh P. Friedman.)

whether I am familar with the terms at this late date. * * * * *.

Q. Did you examine Exhibit No. 1 with reference to the question of whether there might be or was an apparent or actual conflict between the provisions of that [1169] agreement and the agreement Exhibit 11? A. Yes.

Q. Did you form an opinion on that subject at that time? A. Yes.

Q. What was that opinion?

A. That the agreement of September, 1945, between Warner Bros. Pictures, Inc. and United States Pictures did not contravene the terms of the bank loan agreement.

The Court: Exhibit 11?

The Witness: Exhibit 11, and subsequent bank loan agreements which were then in existence.

* * * * * [1170]

Q. Did you, in addition to studying this matter and forming your own opinion, discuss the matter with any attorney representing the banks?

A. Yes.

Q. What attorney was that?

A. Al Houston of White & Case.

Q. Did he give you an opinion on that subject?

A. Yes. [1171]

Q. Was that opinion given to you orally?

A. Orally.

Q. Was there later a writing?

A. It was confirmed in writing.

Mr. Williams: May I point out, if your Honor

(Testimony of Stanleigh P. Friedman.)

of the meeting, we had before us a resignation of Mr. Joseph Bernhard as a director and vice president.

He told us at that time, which was the fact, that we were in the process of drafting an agreement with a company which Bernhard had formed, and which was to include Mr. Sperling, and that this agreement would provide for the production of pictures by an independent group, namely, Sperling and Bernhard and their corporation for distribution by Warner Bros. Pictures.

Then the meeting simply proceeded to the consideration of the resignation and the question of the severance pay for one or two of the men who had withdrawn from the company at that time, including Mr. Bernhard.

Q. Do you remember the name of the other person for whom severance pay was provided at that time?

A. I think it was Charles Einfeld, who was then head of our publicity department.

Mr. Levy: May I have the question read by the [1132] reporter?

(Question read.)

Q. (By Mr. Williams): Incidentally, before we get to the matters about——

Mr. Levy: You say "at that time." Do you mean at that meeting?

Mr. Williams: Yes, at that meeting. You have got the minutes that show that, Mr. Levy.

The Court: Proceed.

(Testimony of Stanleigh P. Friedman.)

please, that the letter from White & Case which is referred to has been marked in this case No. 16. I believe that is in evidence already, your Honor.

Mr. Levy: Plaintiff's Exhibit 16.

Mr. Williams: May the witness examine Plaintiff's Exhibit 16?

Q. I show you now Plaintiff's Exhibit 16 and ask you whether that is a photostat copy of the letter you received from White & Case in reference to this matter, and concerning which you have just testified? A. Yes, it is.

Mr. Williams: I am going to refer now to the matter of the so-called Hemisphere agreement, which has been marked in evidence in this case as Exhibit 3-A. May the witness have an opportunity to examine that agreement? May the witness also examine Exhibit 3 together with 3-A, at the same time?

The Court: Yes.

Q. (By Mr. Williams): You have before you now [1172] Exhibit 3, which is an amendment to the basic agreement and an amendment of the agreement between Warner Bros. and United States Pictures dated May 20, 1946, and also 3-A, which is an agreement between United States Pictures and the Hemisphere Company. Did you at any time examine those agreements? A. I did.

Q. About when was it that you examined the agreements?

A. When they were sent on from the Coast, and I think about the date of the agreements.

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: I am sorry. You were misinterpreting the registry of my face.

Q. (By Mr. Williams): In that connection may I ask you whether it is or is not a fact that Warner Bros. Pictures, Inc. in the past, preceding 1945, through the years has provided severance pay for all the employees who have left the service of the company? A. That is a fact.

Q. In reference to Bernhard's severance pay, was there anything unusual in the practice of the company in his being provided with six months' severance pay?

Mr. Levy: I object to the form of the question on the ground it is compound.

The Court: And do you object on the ground it calls for his conclusion?

Mr. Levy: And I object on the ground it calls [1133] for his conclusion.

The Court: Sustained. I take it you are asking again for understanding.

Mr. Williams: No; I am asking for the practice, whether this was in accordance with the practice. That is what I am asking.

The Court: Sustained.

Q. (By Mr. Williams): Was anything said in reference to Mr. Bernhard's severance pay that it was a condition to this United States Pictures contract that was being made?

A. Not at all. It was our practice to provide severance pay for our employees who had been with the company for a long period of time.

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: I move to strike the latter part of the witness' answer.

The Court: Motion granted.

Q. (By Mr. Williams): Was there a practice in Warner Bros. Pictures, Inc. to provide severance pay in case of employees of executive character who left after long service?

Mr. Levy: I object to the question on the ground it has no bearing upon this particular issue and on the ground it calls for a conclusion.

The Court: Objection overruled. You may answer. [1134]

Mr. Williams: Will you read the question?

(Question read.)

A. Yes.

The Court: I take it you are referring to some particular time——

Mr. Williams: At the time in 1945, yes. I am talking about the practice at the time——

The Witness: Yes; and for years prior thereto.

Q. What was that practice?

A. Six months' pay.

The Court: The company would give a retiring employee six months' severance pay?

The Witness: Correct.

The Court: Did that apply to all employees?

The Witness: Executive employees who had been with the company for many years.

The Court: How many years?

The Witness: I would say ten years.

Q. (By Mr. Williams): In the case of Mr.

(Testimony of Stanleigh P. Friedman.)

Bernhard, he had been with the company more than ten years at that time, had he not?

A. My recollection is that Mr. Bernhard came to the company in 1930 or 1931.

Q. And had been with them continuously——

A. And had been with them continuously with the [1135] exception of a period when he went into the Navy. He was called upon to render expert services to the United States Navy, during which time he was given a leave of absence of some months.

Q. Was it at the meeting on the 25th of September, 1945, that this matter of Mr. Bernhard's resignation and his severance pay was passed on by the Board?

A. That is my recollection, as refreshed by the minutes and the various depositions that I have read.

Q. Was it at that meeting that Mr. Albert Warner explained what you have already testified about the proposed contract with United States Pictures? A. In general.

Q. Yes. Following that meeting on the 28th of September, the record shows there was another meeting of the Board of Directors. Were you present at this second meeting?

A. Yes, I was.

Q. What was done, if anything, with reference to this United States Pictures contract at that meeting?

A. Mr. Warner, who presided—Albert Warner

(Testimony of Stanleigh P. Friedman.)

—said that I had made a study of it and would make available to the members of the Board the contents of the agreement, which I did at length.

Q. Did you have a copy of the agreement with you? [1136]

A. Yes, I had a copy of the agreement with me on the table.

Q. In addition to that, did you have some other document?

A. I had my short analysis of it.

Mr. Levy: When you say "short," you smile; is that what you mean?

The Witness: I say "short" with a smile.

Mr. Levy: I see.

Q. (By Mr. Williams): You had the analysis that you have heretofore referred to that they joked about being almost as long as the agreement?

A. That is right.

Q. At that time, in the presence of the members of the Board, state as fully as you can now remember what you told them with reference to the contents, the substance and the effect of this agreement.

A. I didn't read every paragraph from my analysis, nor of the contract. I skimmed over the contract with my analysis and pointed up the important parts of it, and some questions were asked of me, and I had put myself in a position to be able to answer them, which I did. Some of the directors asked questions about the production—one of them, Mr. Catchings, asked about the pro-

(Testimony of Stanleigh P. Friedman.)

interest on its advances at the same rate as paid for the bank loan, and will also deduct from the profits $50,000. These amounts will be equally divided between U.S. Pictures and Warner.

"Of course, increased distribution and overhead charges will diminish the net profits in which we share. Such profit is also adversely affected by an item of $17,500 for U.S. Pictures and Hemisphere lawyers fees charged to the cost of the picture.

"Mr. Carlisle has made computations on a hypothetical $2,500,000 gross for the picture and his figures show that Warner will receive practically the same financial benefit on the new basis as on the old. ($175,000 on the old against $167,000 on the new). He has also made computations on a basis of $3,000,000 gross and on such basis Warner would get somewhat more on the old basis than on the new ($362,500 on the old basis against $308,000 on the new). His figures are herewith [1178] presented. It should be noted that the larger the gross income the greater the disparity between old and new basis becomes.

"U.S. and Warner each give up the same amount to make the deal on Pursued and share equally in the net return from the production and distribution of the picture.

"If the transaction is approved, please let me know so that I can complete the preparaton of the necessary papers."

Subjoined to this is a typewritten note:

"Mr. Albert Warner in the presence of Mr.

(Testimony of Stanleigh P. Friedman.)

duction of an outside picture, and I was able to explain that. [1137] Someone asked what was the meaning of the word "reasonable" in connection with salaries of the producers.

I remember that Mr. Albert Warner said he had been informed that each of the men, Sperling and Bernhard, had agreed at that time for the present to draw a thousand dollars a week, but my memory doesn't serve me very much as to the other questions.

I think Mr. Guggenheimer asked me a question, but I can't remember what it was.

May I add——

Q. Yes.

A. Of course, the inside directors, those who are employees of the company, were acquainted with the contract. I had discussed it with Mr. Carlisle, and, of course, Mr. Perkins, and Mr. Schneider wasn't there at the meeting. He was at the Coast at the time, but Mr. Perkins and Mr. Carlisle and I, of course, knew the terms and knew the contract and its provisions.

Mr. Levy: I move to strike the latter part of the witness' statement with respect to Mr. Carlisle knowing the terms of the contract and Mr. Perkins knowing the terms of the contract. [1138]

The Witness: I discussed it with both of them.

The Court: Motion granted.

Mr. Williams: As to what they knew only?

The Court: Yes.

Mr. Levy: That's right.

(Testimony of Stanleigh P. Friedman.)

Mr. Williams: You are not striking the part where he said he discussed it with both of them?

The Court: No, the motion was not directed to that.

Mr. Levy: That is right, your Honor.

Q. (By Mr. Williams): About how long a time was taken up in your explanation of the terms of the contract to the board?

A. About an hour; but that is purely based upon the best of my recollection as to time. I didn't time it.

Q. I understand that.

A. The average witness doesn't know the passage of time, anyway.

Q. Did you, Mr. Friedman, endeavor to make a complete explanation of all of the terms of the agreement which you consider to be pertinent to the question whether the agreement shou'd or should not be passed by the board?

Mr. Levy: Mr. Friedman, just a moment, I object to the question on the ground it is immaterial as to the endeavors of the witness.

The Court: Sustained. [1139]

Mr. Williams: Here is a case, if your Honor please, where fraud is alleged.

The Court: You can ask him what he understood he did.

Mr. Williams: That is exactly what I am asking him.

The Court: No, you have asked him, "Did you endeavor?" That is an equivocal term, possibly.

(Testimony of Stanleigh P. Friedman.)

Schneider authorized S. P. Friedman to proceed with the deal according to this memorandum."

Appended to which is a computation handed to me by Mr. Carlisle: "Assuming World Gross of $2,500,000," a comparison of the old basis and the new basis; and the second sheet: "Assuming World Gross of $3,000,000," a comparison of old basis and new basis. [1179]

Q. Did you understand in connection with this deal who were involved in Hemisphere, what personalities were involved in Hemisphere?

A. I was aware.

Q. And who were those persons?

A. Teresa Wright, who played a very important role in Mrs. Miniver, and Niven Busch, her husband, who was the author of the screen play Pursued.

Q. Was any information given to you as to what, if any were the demands of Niven Busch and Teresa Wright as to the use of the play and the service of Wright? A. Yes.

Q. From whom did you get that information?

Mr. Levy: Just a moment. I object to the form unless the witness states about when and where and the circumstances.

Mr. Williams: We are getting to that. I can only do it one at a time.

Mr. Levy: Very well, Mr. Williams.

The Witness: The question, please, Mr. Reporter.

Mr. Williams: The first question was who gave the information.

A. I believe a telephone conversation with Mr.

(Testimony of Stanleigh P. Friedman.)

Mr. Williams: Every term is equivocal when Mr. Levy comes to discussing it.

Mr. Levy: I am sorry, Mr. Williams, but—

The Court: Intend and understand are two terms pretty well settled in the law.

Mr. Levy: I would like to clear myself on the record.

The Court: You don't need to defend yourself, Mr. Levy.

Mr. Levy: Thank you.

Q. (By Mr. Williams): Was it your intention, Mr. Friedman, at the time you explained this matter to the board to fully and fairly explain all of the terms of the agreement to them so that they would have a clear understanding of the character and effect of the contract? A. It was.

Q. Was it your understanding you would so explain it to the board?

A. I understood it; I believed it. [1140]

Q. After you had explained the matter to the board and the questions had been asked, was there any action taken by the board?

A. The board enacted a resolution, the precise language of which you have in the minutes.

Q. Did you vote in favor of that resolution?

A. I believe I did.

Q. At that time was it your intention to vote on a contract which would be for the benefit of Warner Bros. Pictures, Inc.? A. I did.

Q. Did you understand in making your vote

(Testimony of Stanleigh P. Friedman.)

that you were voting on a contract which was for the benefit of Warner Bros. Pictures, Inc.?

A. I did.

Q. Had anybody at any time prior to your vote in any manner, by word, act or deed suggest or intimate to you how you should vote on that resolution? A. Positively no.

Q. Harry Warner or Jack Warner were not present then, were they? A. No.

Q. Had you talked with Jack Warner about that contract before you presented it to the board?

A. No, I had not. [1141]

Q. Had you talked with Harry Warner before you proceeded to present it to the board?

A. I had a telephone conversation with Mr. Harry Warner long before the contract was sent to New York——

Mr. Levy: May we have an identification of which Warner?

A. I said I had a telephone conversation with Mr. Harry Warner long before the contract was sent to New York in which he told me that he had been talking with Mr. Bernhard, Mr. Sperling, Mr. Freston and Mr. Schneider and he reminded me that, he mentioned it to me, that he was trying to put together a deal by which the company, Warner Bros. Pictures, Inc., could have the benefit of this independent producer production group to make pictures on the Warner lot for Warner distribution, but he never discussed this contract with me.

(Testimony of Stanleigh P. Friedman.)

him fully on the basis of that understanding if you wish.

Mr. Levy: Very well, your Honor.

The Witness: The question, please.

(Question read by the reporter.)

The Court: You may answer.

A. Yes, that was my understanding.

Q. (By Mr. Williams): Did you understand in voting for this transaction as a director that you were voting for a transaction which was favorable to the interests of Warner Bros. Pictures, Inc.?

A. Yes.

Q. And was it your intention to vote for a transaction which would be for the interests of that company? A. It was.

Q. Mr. Friedman, I call your attention to the meeting of the board of directors of Warner Bros. Pictures, Inc. which is evidenced by an exhibit in this case, Exhibit No.—I am referring to the meeting of August 17, 1950.

A. I remember the occasion of the meeting, Mr. Williams. [1183]

Q. Oh, yes, that is August 17, 1950, Exhibit No. 23.

A. I remember the meeting of August 17, 1950.

Q. You remember the meeting. That is the meeting at which there was brought up the matter of an extension or an amendment to the basic agreement between United States Pictures and Warner Bros. Pictures, and also some reference to the amendment of December 6, 1947?

(Testimony of Stanleigh P. Friedman.)

Q. Did he at that time make any statement to you with reference to how you should vote on it, if it ever came before you as a director?

A. No.

Q. Now, Mr. Friedman, did you know who Mr. Sperling was at the time of this?

A. Indeed I did.

Q. Was there any discussion before the board as to who Mr. Sperling was, either on the 25th or 28th of September? [1142]

A. There was no discussion, but someone raised the question of what Mr. Sperling's experience had been in the production field. It was answered by Mr. Warner and by me.

Q. What was the substance of what you and Mr. Warner said at that time?

A. Both Mr. Warner and I——

Q. You are referring to Mr. Albert Warner?

A. I am referring to Mr. Albert Warner. Both Mr. Albert Warner and I were aware that Milton Sperling before he went into the service——

The Court: Just what was said in substance at the board meeting?

The Witness: We stated, either Mr. Warner or I stated to the board that Mr. Sperling had been employed by Fox, or 20th Century-Fox, as it afterwards became, prior to going into the service and that he had produced to co-produced certain well known pictures and among them was the outstanding picture To the Shores of Tripoli, and now, relying completely on recollection which may have

(Testimony of Stanleigh P. Friedman.)

A. I remember the meeting.

Q. Yes. Were you present at that meeting?

A. I was.

Q. And prior to the meeting did you have any information as to this matter being brought before the meeting?

A. I was on my holiday down at Nantucket Island, Massachusetts and Mr. Perkins, our general counsel, called me on the telephone and said that it was proposed that there be a further extension of the United States Pictures-Warner program and asked for my oral approval. And I told him that it certainly met with my approval. But the meeting was not held until I got back, and when I got back to New York that meeting was held and the resolution which is in the minutes was enacted by the board of directors.

Q. Was that matter explained to the board there at the time of the meeting?

A. Well, I——

Mr. Levy: Does he know which matter you are referring [1184] to, Mr. Williams?

Mr. Williams: The extension agreement.

A. The extension agreements were stated to the board and what was proposed to do.

Q. You voted in favor of that, did you?

A. I did.

Q. Did all the other directors vote in favor of it?

A. They did.

Q. Did you understand at that time in voting to that effect that you were voting for a matter

(Testimony of Stanleigh P. Friedman.)

been colored by the fact that I read depositions since that time, but I do remember that he made a picture with Sonia Henie who was then a very well known skater. There might have been other pictures produced by Mr. Sperling which were stated by Mr. Warner or by me to the board but I can't recall what they were. I cannot reconstruct the meeting sufficiently to [1143] state that those other pictures were named to the board, but everyone of the members of the board of directors knew Mr. Sperling. They all knew who he was and had been acquainted with him.

Mr. Levy: The latter part of the witness' answer is a little confusing. I don't know whether the witness intends to connote by his answer whether the other members of the board knew that Mr. Sperling had done this or the other thing, or just knew impersonally.

The Witness: Just knew impersonally.

The Court: According to your understanding they all knew he was the son-in-law of Harry Warner?

The Witness: They all knew he was the son-in-law of Harry Warner and were all personally acquainted with Mr. Sperling. They had probably all been to his wedding.

The Court: According to your understanding.

The Witness: According to my belief and understanding. [1144]

Q. (By Mr. Williams): Mr. Friedman, what was your opinion as to whether or not Milton Sper-

(Testimony of Stanleigh P. Friedman.)

which was for the benefit of Warner Bros. Pictures, Inc.? A. Yes.

Q. And did you intend in so voting to take action favorable to the interests of Warner Bros. Pictures, Inc.? A. I did so intend.

Q. Now I call your attention to the stockholders meeting of 1946, that was held in November 1946, and in particular to the notice of meeting and proxy statement accompanying it, dated January 10, 1946, which is Exhibit No. 21 in this case. Are you familiar with that proxy statement?

A. I am familiar with the proxy statement and the notice.

Q. Did you have anything to do with the preparation of the proxy statement?

A. I collaborated in the preparation of it.

Q. And in particular, with reference to that portion of the proxy statement which recites the terms of the deal between Warner Bros. and United States Pictures and the bank arrangements that were being made, did you assist in the drafting of that particular portion of it? A. Yes, yes.

Q. May I ask you what was the purpose of putting this particular transaction into the proxy statement?

A. To conform with the rules of the Security Exchange Commission which required a statement of all transactions with directors.

Q. And because Bernhard had been a director?

A. And because Bernhard had been a director.

(Testimony of Stanleigh P. Friedman.)

ling being the son-in-law of Harry M. Warner should be counted in favor of him or against him at that time, I mean from the standpoint of the company?

A. Oh, from the standpoint of the company I thought it was a very advantageous fact and factor that we would have an independent producer of Milton's caliber, who was related to the president of our company and under such a status of regard by Jack L. Warner as I knew he was.

Q. Was there any person at the meeting of the board of directors which approved this contract who voiced any opposition to the contract?

A. No.

Q. Following the passage of the resolution by the board did you have anything to do with the contract after that?

A. I signed the contract.

Q. You signed it following the meeting at which it was authorized? A. Correct.

The Court: You signed it on behalf of the corporation?

The Witness: On behalf of the corporation. I am a signing officer of the corporation.

Q. (By Mr. Williams): Mr. Friedman, in the course of [1145] business of Warner Bros. Pictures, Inc., when a contract is executed such as that is there any procedure which is followed by the corporation in distributing copies of the contract to certain persons?

(Testimony of Stanleigh P. Friedman.)

Q. Were you present at the meeting of the stockholders which followed? A. Yes, sir.

Q. Was there any objection made by any person to this transaction at that time?

Mr. Levy: Just a moment. That is assuming a state of facts not in evidence: Was there any objection?

Mr. Williams: I am just about to put them in evidence.

Mr. Levy: Was there any objection made by any person to the——

Mr. Williams: At the hearing.

Mr. Levy: ——to the contract Exhibit 1, is that what [1186] you said?

Mr. Williams: Yes.

Mr. Levy: Well, there is no evidence that the matter was brought before the meeting of the stockholders of Warner Bros.

Mr. Williams: The proxy statement itself is in evidence, showing that the members——

The Court: Is the purport of your question to ask the witness did he hear at the stockholders meeting any objection voiced?

Mr. Williams: Any objection voiced.

The Court: To Exhibit 1. Is there objection to the question in that form?

Mr. Levy: May it please the court, we have not in evidence—it seems that we have in evidence all of the stockholders meetings of Warner Bros. beginning with 1947 down to the present, but we

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: I object to the question—withdraw the objection.

A. The practice is for the executive officers or the lawyers who procure the signatures to contracts to send them to what is called our "trust department" where we keep all original papers; and that is what I did with this contract in this case.

Q. (By Mr. Williams): Do you know what the practice of the trust department is with reference to acquainting other departments of the fact and terms of the contract?

Mr. Levy: May it please the court, I have no objection to the witness answering that question yes or no; but if it is going to proceed from that point on and the witness is going to testify as to the moves that are made, the various acts passing back and forth that contract and all of that sort of thing, I will object to it.

Mr. Williams: We haven't got to that point.

Mr. Levy: Very well.

The Court: You may answer the pending question, Mr. Friedman.

The Witness: May the reporter, please? [1146]

(Question read by the reporter.)

A. I do.

The Court: The question relates to September of 1945?

Mr. Williams: To September of 1945.

A. Of it I am sure.

Q. (By Mr. Williams): At that time what was that practice, Mr. Friedman?

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: If the court please, I object to what the practice was at that time. Of course, I would be in no position to object if the witness can state with authority what was done with this particular contract.

The Court: I take it the purpose of it is to show the ordinary course of business. Of course, I assume they would rely then upon the disputable presumption that the ordinary course of business was followed. Is that your purpose?

Mr. Williams: Yes, your Honor.

The Court: You may answer.

A. In general, the contract is skeletonized and copies of the analysis, the digest of the contract, is sent to various departments of the business, and the contracts are immediately photostated and several copies are retained in the trust department files and other copies are sent around to the various departments that will be concerned with the administration of it.

Q. (By Mr. Williams): In the case of a production-distribution [1147] contract what departments are, in the course of business, affected by the contract?

A. Well, in the first place, the production department; secondly, the distribution department; thirdly, the financing department, Mr. Martin, Mr. Carlisle.

Q. How about the accounting department?

A. And the legal department. Well, the finan-

(Testimony of Stanleigh P. Friedman.)

haven't in evidence the minutes of the stockholders meeting of 1946. The witness is being asked——

The Court: Where is that? Where are the minutes of that meeting?

Mr. Levy: I do not know.

Mr. Williams: You never asked for them. We provided counsel with everything they asked for.

The Court: Are they available?

Mr. Williams: They could be available on a day's notice [1187] or so. We have provided counsel with everything they asked for.

Mr. Levy: I believe that I asked for all of the meetings of the stockholders. Maybe I am in error. But, if you will examine my——

The Court: You may have been confused on the year. Do you wish them now?

Mr. Levy: It is possible that I was confused, your Honor.

Mr. Williams: We will get them for him.

Mr. Levy: But the only reason I made the objection, your Honor, is this: I have read the minutes of the stockholders meetings each and every year.

The Court: Including the year 1946?

Mr. Levy: No, your Honor; those that are in evidence, beginning with the year 1947. And when the witness was asked the question: Was any objection raised by any stockholder, I was in the dark and what I wanted to know was—what I wanted to make sure was that the question did not assume a state of facts not in evidence, namely, if

(Testimony of Stanleigh P. Friedman.)

the question had not been brought up at the stockholders meeting at all, to ask a witness a question: Did anybody object to it? would be just producing information, that is, gathering information into this record which would be contrary to the actual fact. And that is the only reason why I interposed the objection and that was why I was careful to note the form of Mr. [1188] Williams' question. Otherwise it would just pass by.

The Court: Do you wish the minutes produced of the 1946 meeting of the stockholders?

Mr. Levy: Yes, your Honor. I have not seen them. I do not know what is in them, but I am quite sure that under the circumstances they would be informative.

The Court: Can they be here tomorrow?

Mr. Williams: They can be here tomorrow.

The Witness: You have got copies here?

Mr. Williams: Not the 1946.

The Witness: You will have to telegraph New York for them.

Mr. Levy: Well, I have no objection to the witness' recollection presently, under the circumstances, until they can be supplied, as long as the witness who was at the meeting will say: This proposition was brought up, et cetera, et cetera, and what transpired. I have no objection to that.

The Witness: Very good. * * * * *

The Court: The question, as I understand it, is this: Did the witness hear at that meeting any ob-

(Testimony of Stanleigh P. Friedman.)

cial is the accounting department, and then the legal department keeps a copy in the files.

Q. Do you have any personal knowledge with reference to this particular contract whether it followed that course?

A. I think it did, but I haven't any—I can't make the statement definitely. [1148]

* * * * *

STANLEIGH P. FRIEDMAN

the witness on the stand at the time of adjournment, was recalled and testified further as follows:

Direct Examination—(Resumed)

Q. (By Mr. Williams): Mr. Friedman, are you familiar with the basic loan agreement between Warner Bros. Pictures and the syndicate of banks headed by the New York Trust Company, which has been marked Exhibit 11 in this case?

A. Just tell me the date.

Mr. Williams: Perhaps the clerk will show Exhibit 11 to Mr. Friedman.

The Court: Exhibit 11, according to Exhibit 102 for [1168] identification, the list, is a loan agreement dated July 21, 1943, between Warner Bros. Pictures, Inc. and a syndicate of banks, the First National Bank of Boston, etcetera and et al.

Mr. Williams: The clerk has now handed the exhibit to the witness, your Honor.

The Witness: I collaborated in the preparation of this document, and I was then familiar with the terms. I am acquainted with it, but I don't know

(Testimony of Stanleigh P. Friedman.)

Q. Yes.

A. I can be sure of that by having a reference to the minutes of the Board of Directors at which this amendment to the basic agreement with regard to Hemisphere Films was enacted or was considered.

Q. If I call your attention to Exhibit 20 in this case——

The Court: Mr. Clerk: Will you place Exhibit 20 in front of the witness?

The Clerk: Yes, your Honor.

Q. (By Mr. Williams): You have before you now Exhibit 20, which is the record, or extracts from the minutes of a special meeting of the Board of Directors of Warner Bros. held on June 18, 1946. Are those the minutes to which you refer that would [1173] help you in answering the question as to the time when you examined Exhibits 3 and 3-A?

A. It states to my satisfaction that I had received the amendatory agreement between Warner Bros. Pictures, Inc. and United States Pictures at or shortly after the date of the agreement, May, 1946, and then I made an analysis of it, a complete analysis of it, in a little bit shorter form, which I presented to Major Warner and Mr. Schneider, which discloses the results of the change as it affected Warner Bros. Pictures, Inc.

Q. Will you state what character of analysis you did make?

A. I have before me a document, which bears date July 2, 1946, and that will give you a very good idea of what type of analysis I made.

(Testimony of Stanleigh P. Friedman.)

The Court: Is that a document heretofore marked?

Mr. Williams: No, it has not been marked, if your Honor please. It might be marked for identification.

Q. Would you refer to that, and from that could you give us a statement of what the details of your analysis were?

The Court: Mr. Clerk, will you mark the document the witness now has as Defendants' Exhibit L for identification.

Mr. Levy: May I glance at it for a moment, your Honor? [1174]

The Court: Yes.

The Clerk: So marked.

(The document referred to was marked Defendants' Exhibit L for identification.)

The Court: Please hand it to counsel.

Mr. Levy: Thank you.

The Witness: May I have the question, Mr. Reporter?

(Question read.)

The Witness: I could.

Q. (By Mr. Williams): Will you do so, then?

A. This is a memorandum which I prepared at the time:

"The deal between Warner, U.S. Pictures and Hemisphere Films, Inc., a newly organized California corporation, the numerical control of whose stock is owned by U.S. Pictures, is on the following basis:

(Testimony of Stanleigh P. Friedman.)

"The basic agreement between Warner and U.S. Pictures is to be amended so as to provide that the second of the six pictures which U.S. contracted to produce for Warner shall be the picture Pursued, which will be produced by Hemisphere on the Warner lot.

"U.S. will lend to Hemisphere 50 per cent of all cost of production which amount U.S. will [1175] borrow in cash and facilities from Warner. The other 50 per cent Hemisphere will borrow from The New York Trust Company. U.S. Pictures and Warner will enter into an agreement with the bank under which the first moneys from the gross receipts of the picture, after deducting distribution fees and expenses, will be paid to the bank until the loan with interest is paid. The profits of the picture will be divided one-third to Warner and two-thirds to Hemisphere (one-half of which will go to U.S. by reason of its ownership of approximately half of the stock of Hemisphere). This compares with the terms of the original U.S.-Warner basic agreement under which Warner would be entitled to 50 per cent of the profits.

"It is estimated that the difference between 50 per cent of the profits which Warner would be entitled to receive under the original agreement with U.S., and the 33-1/3 per cent which it will now receive on the new arrangement covering the picture Pursued will be somewhat made up by the following:

(Testimony of Stanleigh P. Friedman.)

"(i) Warner's participation in increased distribution charges. [1176]

"Under the original basic agreement Warner is entitled to distribution charges of 20 per cent domestic and 25 per cent England, etc. The new agreement with Hemisphere provides that the distribution charge for domestic shall be increased to 25 per cent and for England to 30 per cent, with varying rates for the rest of the world as provided in the original basic agreement between U.S. and Warner. This differential of 20 per cent is to be split 50-50 between U.S. and Warner.

"(ii) Warner's participation in increased overhead charges in respect of this picture:

"U.S. will provide stage space and 'facilities' for Hemisphere on the Warner lot and charge Hemisphere as overhead 45 per cent of all direct cost items of the picture. This compares with a probable average overhead charge of 25 per cent which U.S. Pictures now pays to Warner under its basic agreement with Warner. The differential of 20 per cent will be divided equally between U.S. Pictures and Warner.

"(iii) Warner's equal participation in a 15 per cent service charge on national advertising, interest to be charged on advances, and $50,000 to be deducted from profit before Hemisphere [1177] participates therein.

"U.S. Pictures in its agreement with Hemisphere will charge the latter a service charge of 15 per cent on the national advertising of the picture,

(Testimony of Stanleigh P. Friedman.)

Schwab or Mr. Sperling, but I am very hazy in my recollection of who told me about it.

Q. What were you told? [1180]

A. I was told that this was the deal which the Hemisphere people—which Niven Busch and Teresa Wright were willing to enter into to make this picture with the use of Niven Busch's script.

Q. When were you given that information?

A. At or about the time of the transaction.

Q. Were you given the information before the matter came on before the board of directors of the company? A. Yes.

Q. Were you present at the board meeting when this deal was approved? A. Yes.

Q. The meeting of June 18th? A. Yes.

Q. And was there any discussion of the deal among the directors at that time?

A. There was none.

Q. Was there any explanation of the deal to the directors?

Mr. Levy: Just a moment, please. The witness said "There was none." Does the witness mean no discussion?

The Witness: There was no discussion.

Q. (By Mr. Williams): Was there any explanation of the deal to the directors at that meeting?

A. Yes, I made the explanation of the deal.

Q. Can you state generally what you stated to the board at that time?

A. Relying on my memory, again, I stated to the board that it was proposed to substitute Pur-

(Testimony of Stanleigh P. Friedman.)

sued for the second picture in the production schedule of United States Pictures, Inc.; that the Hemisphere Corporation had been formed between United States Pictures and Wright and Niven Busch and that this picture Pursued would be the second picture in the program of production by United States Pictures. I explained the terms pretty much the same as I explained them in my memorandum to Mr. Warner and Mr. Schneider.

The Court: That is Exhibit L for identification?

The Witness: That is Exhibit L for identification.

Q. (By Mr. Williams): At the time you considered this matter and voted on it did you understand at that time that in order to obtain this story and the services of Teresa Wright it was necessary to make a deal of the character that was involved in this contract? A. Yes.

Q. Did you understand that unless a deal of that character were made, that neither the story nor the services of Miss Wright could be obtained?

Mr. Levy: Just a moment. I did not object to the previous question, your Honor, but this question goes one step further. I think the previous question was to the effect: [1182] Did you understand—well, I forget just what the exact wording was. Now we are going beyond that point, where the witness has to speculate on what a lot of other people had in mind.

The Court: The question merely calls for his understanding. Of course, you may cross examine

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: No. It is in evidence anyhow.

The Court: Granted. Do you mean to ask, Counsel, for his understanding?

Mr. Levy: Yes, your Honor.

The Court: Do you have the question in mind?

The Witness: I haven't the question in mind.

Mr. Levy: I shall ask the question again.

The Witness: Whether the three Warner brothers control my continuance in office as an attorney?

Q. Whether the three Warner brothers control the employment by Warner Bros. of you, yes, Mr. Friedman. A. As an attorney?

Q. As an attorney, yes.

A. The three Warner brothers own about 15 per cent of the stock of the corporation, but if I became persona non grata to any of the Warners or to any other executive, I could not continue as an attorney, and would certainly feel that my presence was no longer required or requested, and I would resign as an attorney.

Q. That is because they are holders of 15 per cent of the stock?

A. That is not the reason; but they are the chief executive officers of the company.

Q. But you said something about 15 per cent of the [1235] stock.

A. I said they own about 15 per cent of the stock, and if you consider that control, I don't want to quibble with you on the word "control."

Q. How do you consider it?

A. I don't consider it control.

(Testimony of Stanleigh P. Friedman.)

Q. You don't consider it working control either?

A. I don't consider it working control either.

Q. Do you consider it as having considerable influence on the affairs of the corporation?

A. I would say it was quite a nucleus by which to obtain additional stock by proxy.

Q. And that is the extent to which you think the Warner brothers had an advantage over any other stockholder in the situation?

A. Absolutely.

Q. Only by virtue of the fact that 15 per cent of the stock ownership was a nucleus from which it could thereafter proceed to gather together the rest of the stockholders to act in accordance with what they conceive to be the thing to do?

The Court: "It could"?

Mr. Levy: They—whether the ownership or control of 15 per cent of the stock——

The Court: The question now is whether the witness [1236] understands it.

The Witness: I understand it, and I would like to answer it.

The Court: Very well.

The Witness: The Messrs. Warner have been the executive officers of this corporation from its inception. They have brought the corporation through thick and thin, financial difficulties of all kinds——

Q. (By Mr. Levy): May I interrupt?

A. Please let me continue. I am entitled to answer your question, and the fact that they have done so well for the corporation, coupled with the fact

(Testimony of Stanleigh P. Friedman.)

jection voiced to the transaction which is embodied in Exhibit 1? [1189]

Mr. Levy: Assuming such transaction was presented to the stockholders.

The Court: No, without assuming anything.

Mr. Williams: Without assuming anything.

The Court: Except there was a meeting, he was present, and did he hear——

Mr. Levy: Any objection?

The Court: ——any objection voiced, and you may cross examine him on it.

Mr. Levy: Very well, your Honor.

The Court: You may answer.

A. My answer, heretofore given, is that no objection was voiced by anybody at the meeting of the stockholders.

Mr. Williams: You may cross examine.

The Court: Before we leave the subject of the minutes——

Mr. Williams: We will get them as soon as we can. I thought we might possibly have a copy in my office, but if we have not, we will telegraph to New York for them today.

The Court: Very well.

Mr. Williams: I assume a copy is all that is necessary.

Mr. Levy: Surely. * * * * * [1190]

Cross Examination

Q. (By Mr. Levy): Taking that last meeting up that we just referred to, Mr. Friedman, before

(Testimony of Stanleigh P. Friedman.)

we go any further, you were present at that meeting?

Q. You are referring to the stockholders meeting?

Q. Yes, of 1946? A. Yes, I was.

Q. Was the question presented at all to the stockholders, namely, the agreement between United States Pictures and Warner Bros. Pictures?

A. I am in doubt about that.

Q. In other words, did anybody get up and say—— A. Excuse me. I did not——

Q. ——an agreement has been entered into between our corporation and Warner Bros. Pictures, and this, that or the other thing are parts of the agreement? Did anybody say anything like it?

A. I am in doubt about it, but I believe that Judge Morris, Hugh Morris, former Federal Judge in Wilmington, Delaware, who presided at the meeting read a memorandum which might have—I believe it did—mention the fact that the contract such as advised to our stockholders in the proxy statement had been entered into between the corporation and United States Pictures. [1191]

Q. Mr. Friedman, you were present at that meeting? A. Yes.

Q. In your opinion, Mr. Friedman, had you been a stockholder who was merely attending that meeting, without any previous knowledge of any of the doings of the corporation, but having before you merely the proxy statement and having read carefully, for that matter, the proxy statement and

(Testimony of Stanleigh P. Friedman.)

having heard whatever was said by whomsoever who said it, in your opinion would you have known the substance of the agreement between Warner Bros. Pictures and United States Pictures?

Mr. Williams: That question is objected to on the ground it calls for conclusion and speculation on the part of the witness, and incompetent, irrelevant and immaterial.

The Court: Objection sustained.

Q. (By Mr. Levy): Were you a stockholder?

A. Yes.

Q. Of Warner Bros.? A. Yes.

Q. I understood you to say that you collaborated on the drawing of the proxy statement—right?

A. I do not know what your understanding was, but I so stated.

Q. And with whom did you collaborate in the drawing of that proxy statement? [1192]

A. With Mr. Perkins, Mr. Bareford and Mr. Hessberg. Bareford and Hessberg are lawyers and assistant secretary. Mr. Perkins is general counsel.

Q. Yes. * * * * *

Mr. Williams: 21, your Honor, is the proxy statement.

Mr. Levy: Yes, that is the one I referred to, 21.

* * * * *

Q. (By Mr. Levy): Now, Mr. Friedman, on page 3 of [1193] Exhibit 21, you testified that the paragraph of that exhibit which is headed by the words "Transactions between the corporation and directors," which proceeds down to almost the bot-

(Testimony of Stanleigh P. Friedman.)

tom of the page of that exhibit and which is followed by another paragraph making reference to the loan agreement between Warner Bros. and The New York Trust Company, which continues on to the top of the following page of this exhibit—I understand that you were the author; is that what you want us to understand, that you authored that, that language?

A. Your question is what you understand. What I testified to was that I collaborated.

Q. Did you author that language?

A. I collaborated in the language.

Q. And the object of both of these paragraphs was merely to satisfy SEC regulations, is that correct?

A. That is one of the objects, and the other object is to advise the stockholders of the transactions.

Q. You say that that was one other object of those two particular paragraphs?

A. Correct.

Q. To advise the stockholders of what, Mr. Friedman?

A. To put them on inquiry if they wished further notice, to advise them that there were these transactions with directors. [1194]

Q. With directors?

A. With directors.

Q. But with nobody else, is that right?

A. No one else?

Q. That was close to the corporation?

(Testimony of Stanleigh P. Friedman.)

A. I beg pardon.

Q. With nobody else. These paragraphs were not directed to putting the stockholders on notice that a son-in-law of the chief executive of Warner Bros. is or was to be connected with the particular transaction covered by these two paragraphs?

A. Well, certainly——

Q. That was not an object, was it?

A. No, that was not an object.

Q. You knew at the time, of course, as you testified that Milton Sperling was going into partnership or to be half-owner of stock of United States Pictures, did you not? A. Correct.

Q. And you did not think, did you, it necessary for the stockholders to be informed of that fact, did you? A. I did not.

Q. Although the relationship was present in your mind and you had an awareness of it at the time that you satisfied SEC regulations by the inclusion of these paragraphs, is that correct? [1195]

A. I was aware of it.

Q. So that you would say that these paragraphs were intended to satisfy SEC regulations, and in addition to that, put the stockholders on inquiry with respect to a transaction had between the corporation and a relative of its chief executive?

A. Yes, sir.

Q. You still cling to that answer, do you?

A. I still cling to that answer.

Q. I see. Is it fair to ask you whether or not you thought it important at that time that the

(Testimony of Stanleigh P. Friedman.)

stockholders be informed of the relationship between the chief executive of Warner Bros. and one of the persons interested in the contract that you were describing?

A. If I had thought it important, I would have suggested that it be incorporated in the notice or in the proxy statement. I did not think it was important.

Q. Did you give it consideration before you came to the conclusion as to whether it was important, in your opinion, or not? A. Yes.

Q. And did you consult with anybody else on that particular phase of it? A. Yes.

Q. And after consultation with some other persons, you [1196] concluded it was the concensus, or was it the unanimous opinion of those with whom you collaborated, that the thing had better not be mentioned?

A. It was the concensus of opinion that it need not be mentioned.

Q. That it need not be mentioned?

A. Correct.

Q. Nobody dissented from that view?

A. No one dissented.

Q. And may I ask now with whom you had these discussions on that particular subject?

A. Mr. Perkins, Mr. Harold Bareford, Mr. Edward Hessberg.

Q. Mr. Carlisle?

A. Well, he may have been consulted on other

(Testimony of Stanleigh P. Friedman.)

terms, other provisions of the proxy statement, or Mr. Martin who works with him.

Q. Mr. Catchings? A. No.

Q. Mr. Guggenheimer? A. No.

* * * * * [1197]

Q. Did you oversee, in any way, or did you do any act, or were you consulted in any way, with respect to the [1229] performance by the parties to that contract?

A. Only with respect to the extensions when they were brought before the Board of Directors, of which I had knowledge in advance; but the performance of the contract I was not kept advised of.

Q. You are speaking of which contract?

A. The basic agreement as amended.

Q. So that from the time the basic agreement was made, namely, Exhibit 1, down to this very day, you had no knowledge of any kind as to what was done in the performance of it, with the exception of such knowledge as came to you when the subject of its amendment was presented to the Board of Directors?

A. And where it was necessary for banking arrangements to be included—where the amendments were required in connection with banking arrangements, then I would know what the figures were, to some extent; but in the course of the years from 1945 to 1953 I had no direct connection with performance of the contract.

Q. May I ask you, Mr. Friedman, at whose instance were you elected a director of Warner Bros.?

(Testimony of Stanleigh P. Friedman.)

A. I was elected, I think, on the nomination of the Messrs. Warner. I was elected by the Board of Directors to fill a vacancy in 1930.

Q. Just prior to 1945, prior to September 28, 1945, [1230] at whose instance were you re-elected a member of the Board of Directors?

A. The Board of Directors names a slate and I was named by the Board of Directors.

Q. Who in the Board of Directors does the naming of the slate originally? Who originally composes the slate?

A. The presiding officer asks, "Are there any recommendations for change in the Board of Directors?"

Q. Whom does he ask?

A. He asks the Board of Directors.

Q. He doesn't ask that of Mr. Harry Warner?

A. If Mr. Harry Warner is the presiding officer, he would do that; or if Mr. Albert Warner is the presiding officer, he would do that.

* * * * * [1231]

Q. Let me ask you this question pointblank: Is it generally Mr. Harry Warner who is asked if he wishes to make any changes in the personnel of the Board? A. Never in my presence.

Q. Let me ask you this question pointblank: Does Mr. Harry Warner, in effect, control the naming of the Board of Directors?

A. My statement is, unequivocally, "No."

Q. Have you read Mr. Carlisle's deposition?

A. Yes.

(Testimony of Stanleigh P. Friedman.)

Q. I direct your attention to what Mr. Carlisle said in his deposition.

Mr. Williams: I object to the witness being called upon to comment on the testimony of another witness.

Mr. Levy: I am not calling upon the witness to comment upon the testimony of another witness. I haven't finished my question.

The Court: The objection is overruled. Complete your [1232] question.

Q. (By Mr. Levy): Mr. Carlisle was asked as follows:——

The Court: You are reading from where?

Mr. Levy: I am reading from Exhibit 113 in evidence.

The Court: Page and line?

Mr. Levy: Page 45, line—I am afraid I cannot answer that question without counting the lines, because there are no numerals in the margin.

The Court: Toward the foot of the page?

Mr. Levy: Toward the foot of the page.

The Court: Very well; you may proceed.

Mr. Levy: This question was asked of Mr. Carlisle:

"Q. At whose instance were you elected a director of this company, Mr. Carlisle?

"A. Mr. Warner.

"Q. Which Warner? A. H.M.

"Q. I take it that as annual election of directors takes place, the directors are nominated by a group, a committee?

(Testimony of Stanleigh P. Friedman.)

"A. It is generally Mr. Warner there that is asked if he wishes to make any changes.

"Q. And he in effect controls the naming of the Board of Directors, does he not?

"A. That is those inside the organization. [1233]

"Q. Yes. And are you mindful of that?

"A. Yes.

"Q. Mr. Warner and his two brothers in effect control, do they not, whether or not you shall stay on as controller or assistant treasurer of the company? A. Certainly."

Q. I ask you, Mr. Friedman, does Mr. Warner and his two brothers in effect control whether or not you shall stay on as an attorney for Warner Bros. Pictures, Inc.?

Mr. Williams: Just a moment, before you answer that question. I have no objection to the question whatsoever, but I object definitely to the including of the reading of the testimony of another witness in the matter as making it argumentative in form and asking by implication for an improper comment on the veracity or correctness of the testimony of another witness.

The Court: It is preliminary to the asking of the question, I take it. It is not a part of the question.

Mr. Williams: If it is understood it is not a part of the question, I move to strike that part as being a voluntary statement by counsel which has no place in the record. [1234]

The Court: Do you resist the motion to strike?

(Testimony of Stanleigh P. Friedman.)

that they own 15 per cent of the control would indeed be a nucleus from which they could get huge stockholder proxies for re-election of directors.

Q. But you concede now, do you, or, if you don't, please say so, that for whatever the reason is, the Warner brothers had control of this company?

A. They had 15 per cent of the stock of the company.

Q. And that they controlled the operation of the company, did they not?

A. I think that their opinions would be very much valued, but to say that they controlled the operations of this company simply by virtue of the fact that they own 15 per cent of the stock is not accurate. [1237]

Q. In your judgment, Mr. Friedman, did they control the over-all policies or the basic policies of this company, in your opinion?

A. I think they did, but not by virtue of the fact that they own 15 per cent——

Q. Irrespective——

Mr. Williams: Just a moment. May the witness be allowed to finish his answer?

The Witness: May I finish?

The Court: Yes, finish your answer.

The Witness: I said I think they would, but not by virtue of the fact that they own 15 per cent of the stock of the corporation.

Q. (By Mr. Levy): But by virtue of what?

A. By virtue of their past history and the suc-

(Testimony of Stanleigh P. Friedman.)

cess with which they have managed the corporation from its inception right down to this date.

Q. But, nevertheless, you concede that they controlled the policies of this corporation?

Mr. Williams: Just a moment. That question is objected to as having been asked and answered; and on the further ground it is argumentative in form.

The Court: Sustained.

Q. (By Mr. Levy): Mr. Friedman, before the Board of Directors acted on the contract, on the basic agreement, [1238] Exhibit 1 in evidence, at the meeting of September 28, 1945, did Major Albert Warner in substance convey to the directors present that the agreement was a good one for Warner Bros. and a beneficial one for Warner Bros.?

A. He gave it as his opinion that it was to the advantage of Warner Bros. Inc.

Q. Would you say that he recommended its adoption?

A. I would say that he recommended its adoption.

Q. Would you say that in what he said he conveyed to the Directors present that Harry, Jack and Albert Warner would like to see the Board adopt this resolution?

A. I don't think that is a fair statement. I don't think that he said they would like it adopted. They wanted it submitted to the Board of Directors for their consideration, and the approval was recommended by Mr. Albert Warner.

(Testimony of Stanleigh P. Friedman.)

Q. You are narrating what happened, but what I am asking you is this—you were present: I ask you whether from what you heard Mr. Albert Warner say, did he convey to you, as an individual, now, the impression, did you carry away the thought, in other words, were you made aware, were you conscious of the fact that Harry, Jack and Albert Warner would like to see the Board adopt this resolution? A. I carried away the thought——

Q. Yes or no. [1239]

A. I can't answer yes or no.

The Court: Counsel, you are master of the question but the witness is master of the answer. He is under oath.

Mr. Levy: I thought it was a categorical question.

The Witness: May I have the question?

(Question read.) [1240]

The Witness: May I have the question, Mr. Reporter?

(Question read by the reporter.)

A. I carried away the thought that they recommended this deal as beneficial to the corporation but wanted to submit it to the board of directors for their consideration.

Q. (By Mr. Levy): The fact that a son-in-law of the chief executive of the corporation was involved, and directly and indirectly in the issue before you, did that play a part in the ultimate impression that you carried away with you from the words of Mr. Albert Warner?

(Testimony of Stanleigh P. Friedman.)

A. I think it enhanced the value of the contract to Warner Bros. Pictures, Inc.

Q. In other words, it struck you as the more favorable because of that circumstance?

A. Correct. [1241]

* * * * *

Q. Did you have anything to do, directly or indirectly, with the amendment to the master contract which was made with respect to this Hemisphere business on December 9, 1947?

The Court: Exhibit?

Mr. Levy: Exhibit 5 in evidence. [1243]

* * * * *

Q. (By Mr. Levy): Did you participate either in the drawing of that agreement——

A. No.

Q. ——or in any of the negotiations——

A. No.

Q. ——that entered into it? A. No.

Q. This was out of your ambit entirely?

A. At that time it was, yes.

Q. Are you familiar with the transaction that is involved there?

A. I am aware of it. I am not familiar with it.

Q. You can contribute no information to this court with respect to any part of it, in your opinion? A. Regretfully, no.

Q. I see. You are aware, are you not, Mr. Friedman, that the December 6, 1947 amendment to the master contract which is Exhibit 4 in evidence was not presented to the board of directors of Warner

(Testimony of Stanleigh P. Friedman.)

Bros. for approval or disapproval at all? Are you aware of that fact?

A. I am aware of it, yes. [1244]

* * * * *

Q. Mr. Friedman, I did not ask you why it was not presented to the board of directors. I merely asked you when you first became aware that there was such a thing as Exhibit 4.

A. When I got back from my holiday about the 15th of January in 1948.

Q. Then you found certain memoranda on your desk which indicated— —

A. I had a copy of the letter of transmittal to the [1245] trust department with the terms, the highlights of the amendment.

* * * * *

Q. Were you aware of the fact that on March the 3rd, 1947 Mr. Harry Warner had guaranteed a promissory note of United States Pictures to the extent of $150,000?

A. I don't—I can't say that I was aware of it at the time. It is hard for me to relate that knowledge to any particular time. I knew of the fact that Mr. Warner had guaranteed, endorsed a note of United States Pictures, but I can't relate that knowledge to any particular time.

Q. Is your recollection sufficiently active on that subject that you can say with some reasonable certainty how long after you came back from your vacation and found these documents on your desk did you ascertain the fact that Mr. Harry War-

(Testimony of Stanleigh P. Friedman.)

ner had guaranteed, had individually guaranteed an obligation of United States Pictures to the tune of [1246] $150,000?

A. I didn't. If I may correct you, please, I didn't find the documents. I found a copy of the letter of transmittal.

Q. Yes.

A. Of December 26, 1947. And I am about to answer your question directly by saying I do not believe I had knowledge at that time that Mr. Warner, Mr. Harry Warner had guaranteed the loan.

Q. I see.

A. But it would be impossible for me to relate the time of my knowledge to any specific period.

Q. But at any rate, you are specific and certain on this subject, that on December 6, 1947 you did not know that Harry Warner had theretofore, on March 3, 1947, guaranteed such an obligation?

A. I don't think I did, Mr. Levy.

Q. Having received that letter of transmittal which indicated that that amendment had gone through the various departments of Warner Bros., among which was the trust department, you did not call a meeting of the directors of Warner Bros., did you, to approve that particular transaction?

A. No, I did not.

Q. Although it had already been set in motion?

A. I did not. [1247]

Q. Can you explain why you did not?

A. I tried to explain before.

(Testimony of Stanleigh P. Friedman.)

Q. Maybe the explanation was lost on me. I am sorry.

A. When I saw the letter of transmittal, the copy of the letter of transmittal, a copy of which was directed to Mr. Carlisle and Mr. Schneider, it just passed away and I didn't think enough of it to bring it before the next meeting of the board of directors.

Mr. Levy: May I have Exhibit 4, please?

Q. You read the letter, though, didn't you, carefully? A. My letter I read.

Q. Did you read Exhibit 4, that amendment?

A. No. No, I didn't.

Q. Did you get it?

A. I didn't get it, no. I only had a copy of the letter of transmittal.

Q. Oh, I see. So that, in other words, what you got was a document that called your attention to the fact that such an amendment had been executed? A. That is right.

Q. But contents of the amendment were not made known to you, is that correct?

A. Three or four high spots of the amendment, the change in the terms, the extension, and the change in the overhead and the distribution of profits. I think there were [1248] three or four.

Q. Were called to your attention?

A. Points that were called to the attention of the addresses of the letter.

Q. Might I ask you this, Mr. Friedman, to the best of your recollection was the following called

(Testimony of Stanleigh P. Friedman.)

to your attention: —and this is a letter addressed by Warner Bros. to United States Pictures, Warner Bros. saying the following to United States Pictures:

'You agree that, prior to the commencement of the principal photography of any of the photoplays hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay, as hereinbefore referred to."

Do you recall whether the letter of transmittal advised you of the fact that that was part of the amendment that had been executed?

A. I couldn't say for sure, but I think it did.

Q. You think it did. Did that make any impression on you, if it did? A. No.

Q. Did you know what was meant by those words? A. Yes. [1249]

* * * * *

Q. No. I am talking of the time that you got the letter of transmittal. Did you regard this as an important change in the relationship between Warner Bros. and United States Pictures?

A. I regarded it sufficiently as putting me on notice to examine the document and I obtained the document from the trust department. [1252]

* * * * *

Q. Now we are down to, let us say, about February of 1947, aren't we? A. '48

(Testimony of Stanleigh P. Friedman.)

Q. '48. I beg pardon. '48, when you examined this Exhibit 4? A. That is right.

Q. Now, tell me, Mr. Friedman, is there any explanation for not having called a board of directors meeting after you examined it?

A. I gave it to you.

Q. And it was?

A. That it slipped my attention. I don't know that I was the one charged with bringing it before the board, but at any date, it slipped my attention. I didn't arrange to have it brought before the board at the next meeting. I don't know when the next meeting took place, but I didn't arrange it.

Q. Was it ever brought before the board?

A. Yes, it was.

Q. When? A. In 1950.

Q. Three years later, is that right?

A. Two years later.

Q. Well, December 6, 1947 to July 21, 1950?

A. It was received by me on January 18th or January [1253] 28th, somewhere like that, in '48, and the next meeting of the board of directors was on July 17—I beg your pardon. The next time it was brought before the board was July 12, 1950.

* * * * *

The Court: The second amendment you refer to, is that Exhibit 7 here in evidence?

Mr. Levy: Yes, your Honor.

Q. For the first time then did the board have before it the question of the amendment to the master contract which had already been in opera-

(Testimony of Stanleigh P. Friedman.)

tion for some three years, two and one-half years, is that correct?

A. I haven't any knowledge of that matter being [1254] brought before the board of directors or any individual director before that time.

Q. Yes. Now, on August the 17th, 1950 the board of directors of Warner Bros. met once again to consider what to do with another amendment which was proposed, is that right?

A. An amendment to extend the time to make three additional pictures.

Mr. Levy: That is number what?

Mr. Williams: Exhibit No. 7.

Mr. Levy: Exhibit No. 7.

The Court: Apparently Exhibit 23 is the minutes of a special meeting of the board of directors of August 17, 1950. Is that what you refer to?

Mr. Levy: Yes, your Honor.

The Court: Do you have Exhibit 23, Mr. Clerk?

The Clerk: Yes, your Honor.

Q. (By Mr. Levy): Mr. Friedman, on the 17th of August, 1950 the board of directors of Warner Bros. met and the following people were present: Albert Warner, Waddill Catchings, S. Carlisle, S. P. Friedman, C. S. Guggenheimer, R. W. Perkins and Samuel Schneider and Morris Wolf. I say they were present. I am reading from Exhibit 23 which so indicates.

A. You are not reading from the waiver of notice, are [1255] you?

A. No, I am not reading from the waiver of

(Testimony of Stanleigh P. Friedman.)

notice. I am reading from the secretary's certification, namely, that a special meeting of the board of directors was held that afternoon of that day and there were present the following people. I ask you, Mr. Friedman, when you walked into that board of directors' meeting on that day were you aware of the fact that Cloak and Dagger had been produced, Pursued had been produced, and My Girl Tisa had been produced?

A. I believe so.

Q. Were you aware of the fact that Cloak and Dagger was a profitable picture, that Pursued was a profitable picture, namely, that there was a profit in it for both Warner Bros. Pictures and United States Pictures which they had divided?

A. I believe I knew that.

Q. Were you similarly aware of the fact that My Girl Tisa had been an unprofitable picture?

A. I was aware of that.

Q. Were you aware of the fact that the picture My Girl Tisa had cost in the neighborhood of a little less than $2,000,000 to produce and that it had grossed in the neighborhood of $600,000 or $700,000 all together? Were you aware of that fact?

A. I don't think so. I don't think I was aware of the [1256] figures.

Q. Were you aware of the fact that it was an expensive picture to produce? A. No, no.

Q. Were you aware of the fact that the grosses on it were extremely disappointing?

A. I was not aware of that.

(Testimony of Stanleigh P. Friedman.)

Q. But you were aware of the fact that the picture had caused a loss to the people who were interested?

A. I was not aware that it had caused a loss, but I was aware of the fact that it was not a successful picture.

Q. And that is as far as your knowledge went?

A. That is as far as I had any knowledge or that was brought to the attention of the directors.

* * * * * [1257]

Q. Mr. Friedman, let me put it this way: Let us assume that somebody got up in that meeting of August 17, 1950 and notified you to the following effect: Mr. Friedman, My Girl Tisa has resulted in a loss of $1,200,000; Warner appears to have lost approximately $800,000 and some [1264] odd as the result of the production of that picture. If United States Pictures does not produce a successful picture in its fourth venture, namely, a picture which would produce profits so that Warner can recoup out of the fourth picture, the loss that it sustained on the third picture, namely, My Girl Tisa, Warner would be in the position where it would have to look to the fifth picture, if possible, to recoup its loss sustained on the third picture; and if it did not recoup it on the fifth picture, it would have to recoup it out of the sixth picture if it was there to recoup from on the sixth picture; and if after the sixth picture had been produced and Warner had not recouped its $800,000 loss, then United States Pictures would be obligated to

(Testimony of Stanleigh P. Friedman.)

pay Warner that $800,000 four years from the first general release of the last picture produced by United States Pictures?

A. Is that a question? Is that a question to me?

Q. If someone had told you that?

A. Is that a question to me or argument?

A. No, no. I am directing a question to you. If somebody had gotten up and made that statement to you at that time and informed you gentlemen on the board of directors that that was the fact, would you have taken that into consideration?

A. Nobody did.

Q. Nobody told you? [1265]

A. Nobody told us that. Nobody raised that question. You are calling upon me to speculate whether my brother would have liked green cheese, and I say I have no brother.

Q. That may be right, Mr. Friedman. Are you aware of the fact, Mr. Friedman, that on August 12, 1952 a further extension of time was granted by Warner Bros. to United States Pictures? A. I am aware of that.

Q. Of the performance of the terms of the basic agreement?

A. I am aware of the existence of the contract you have just referred to, August 12, 1952 I believe it is.

Q. Was there a meeting of the board of directors that preceded or succeeded the signing of that extension? A. I don't recall.

(Testimony of Stanleigh P. Friedman.)

The Court: That is Exhibit?

Mr. Levy: Schedule H attached to the Plaintiff's Exhibit 107 in evidence.

Q. Do you not recall whether there was a meeting or not?

A. I don't recall whether there was a meeting or not.

Q. So far as you know, that agreement was just signed by Mr. Obringer without any authority from the board of directors?

A. I don't know, Mr. Levy. If I did, I would tell [1266] you. [1267]

* * * * *

Q. (By Mr. Levy): Do I understand correctly, Mr. Friedman, that after Mr. Freston had prepared Exhibit 1, you authored an addition to it or a change in it? A. I so testified. [1270]

Q. And it was you who inserted the clause that Exhibit 1 in effect shall not become operative until November 7, 1945?

A. I drafted that clause.

* * * * *

Q. (By Mr. Levy): Was there any relation between the payment to Mr. Bernhard of his salary up to November 7 and the inclusion of that particular clause by you into that contract?

A. No—I just included it because Mr. Bernhard [1271] requested that this contract become operative at that future time, and it might have been in his mind that he was going to draw the

(Testimony of Stanleigh P. Friedman.)

$3,000 a week until that time, but I had no awareness of that.

Q. Who requested you to insert that clause in that contract?

A. My recollection is that Mr. Bernhard did.

* * * * *

Q. To the best of your recollection, when did you have that conversation with Mr. Bernhard?

A. A week or two before the date of Exhibit 1.

Q. A week or two before September 28, 1945, at which time the Board of Directors approved the contract? A. Yes. [1272]

Q. In other words, you had had a contract in your possession for a week or two prior to the meeting of September 28?

A. I believe so.

* * * * *

Q. Coming back to the meeting of September 25, 1945, the meeting of the Board of Directors, Mr. Bernhard prior to that time had already told you he wanted you to include this November 7 clause in the contract?

A. Prior to the meeting, yes.

Q. Prior to the meeting at which the Board voted him $78,000 severance pay; is that correct?

A. Yes, that is correct. * * * * * [1273]

Q. I believe you testified you had known Milton Sperling since 1932. Did you say that, or did Mr. Freston say that? I have forgotten.

A. I was at his wedding.

(Testimony of Stanleigh P. Friedman.)

Q. You were at his wedding. That was in 1939, wasn't it?

A. I think so. I have forgotten when. Whenever his wedding was, I was there. [1275]

* * * * *

SAMUEL SCHNEIDER

called as a witness on behalf of the defendants, having been first duly sworn, testified as follows:

* * * * *

Direct Examination

Q. (By Mr. Williams): Mr. Schneider, you are employed by Warner Bros. Pictures, Inc.?

A. I am.

Q. How long have you been in the employ of that company? A. 30 years.

Q. What is your present capacity with the Company?

A. I am a vice president. I am a director.

Q. How long have you been a vice president?

A. Since 1944. [1298]

Q. How long have you been a director?

A. Since 1944.

Q. Prior to that time, what were your positions in the Company, beginning with when you first started there?

A. I started in the accounting department, and I have gradually worked in practically all of the departments of the Company, and at present I would designate my position as assistant to the president.

Q. Are you active in all phases of the business

(Testimony of Samuel Schneider.)

of Warner Bros. Pictures, Inc. and its subsidiary companies? A. I am.

Q. Which includes matters of production, distribution, and, when they had theatres, exhibition?

A. Yes.

Q. You had your offices in New York City, I take it? A. Yes.

Q. In addition to the work you do at New York, do you from time to time go to other places in the country in connection with the business of Warner Bros. Pictures, Inc.? A. I do.

Q. To what places?

A. I make periodic trips to the West Coast Studios, I would say about two times a year. I have made trips throughout the country to our distribution branches. I [1299] have made many trips to the foreign countries.

Q. All in connection with the business of Warner Bros.? A. Yes.

Q. In your functions, do you keep in touch with Harry M. Warner, Jack Warner, Mr. Perkins, Mr. Carlisle, Mr. Friedman, Mr. Blumenstock, and Mr. Kalmenson, and the other department heads of Warner Bros. Pictures, Inc. and its subsidiaries? A. Yes, I do.

Q. Mr. Harry M. Warner is normally on the Coast? A. Yes.

Q. And has been for a number of years past?

A. Yes.

Q. What is your method of communication with him?

(Testimony of Samuel Schneider.)

A. We constantly talk on the phone. During my trips to the Coast I am practically fifty per cent of my time with him, and during his trips to New York we are constantly discussing business matters.

Q. How about your relations with J. L. Warner? A. The same.

Q. In other words, your communication with him on production matters is by telephone, and also you meet him personally on the Coast, or if he happens to be back East? A. Yes.

Q. Is that true of the contact with other heads of [1300] Warner Bros. and its subsidiaries?

A. Yes.

Q. In the practice of the Company on matters involving large sums of money and other matters of importance to the Company, when they come up, is there a practice with reference to the discussion of the various features of those matters among the executive officers of the Company?

A. Yes. Any important matter in our company is discussed between the Warners, myself, and the heads of the departments.

Q. Do you have in mind the contract which has been marked in evidence in this case as Exhibit 1, which is the contract dated the 28th of September, 1945, between Warner Bros. and United States Pictures? A. Yes.

Q. Are you familiar with that contract?

A. I am.

Q. When did you first learn of the fact that a

(Testimony of Samuel Schneider.)

deal of some sort involving Milton Sperling was in contemplation?

A. I would say at least a year before the signing of the contract. During my trips to the Coast and during Mr. Warner's visits in the East, we discussed the possibility of Milton Sperling being connected with our Company. [1301]

Q. What was the substance of what was said by Mr. Warner and of what was said by you on that subject?

Mr. Levy: May we have some expression from the witness as to the time that he is referring to?

Mr. Williams: I will do that, your Honor.

Q. You said that you first learned of this, or this matter first came to your attention about a year before the contract was signed. How many conversations, as nearly as you can remember, did you have on that subject with Mr. H. M. Warner?

Mr. Levy: May I ask which subject counsel is referring to?

Mr. Williams: The subject we are talking about.

Mr. Levy: May the subject be described a little more definitely?

The Court: You are referring to Exhibit 1?

Mr. Williams: I was referring to the matter of Milton Sperling becoming associated in some manner with Warner Bros., which is the subject I directed the witness' attention to in the previous question.

The Witness: I would say a half a dozen times.

Q. Were those times during the interim between

(Testimony of Samuel Schneider.)

the year before September 28, 1945, and that date?

A. Yes; approximately.

Q. Can you any more closely remember or state at the [1302] present time the date or time of any one or more of those conversations?

A. I know that I visited the Coast at least twice during that year, as I do every other year, and I know Mr. Warner was in New York, and we had long discussions about Milton Sperling as we do about other important matters.

Mr. Warner asked my opinion as to Milton Sperling becoming associated with our company, and in what capacity, and how would he fit into our business; and I gave him my opinion.

Q. What did he say in those conversations and what did you say in those conversations? Be a little more specific, or as specific as your memory will permit.

I want as much of the conversations as you can remember.

Mr. Levy: May it please the court, may we have an expression from the witness as to when this first conversation occurred, or is he about to refer to all of the conversations; in other words, the substance? Is he going to give us the substance of all of his conversations in his one answer; or is he going to give the substance of the first conversation and progressively go on until it comes to the sixth or seventh?

I object to the form of the question on the ground [1303] that the answer will not be suffi-

(Testimony of Samuel Schneider.)

ciently informative of the facts that we are seeking to be brought out. [1304]

Mr. Williams: It will be our misfortune, I suspect, your Honor. I thought I was making it clear that the witness was to answer as to the substance of all these conversations that were being had during that period of time preceding in connection with this contract. If I was not sufficiently clear, I will now ask him.

Q. Are you able to differentiate or state as between these various conversations what was said at one of them and what was said at another?

A. I couldn't possibly say at what date I had a conversation. I can only refer to the visits that I made to the coast and Mr. Warner's visit to the East, during which time we discussed Milton Sperling as well as other matters.

The Court: Are you able to relate the substance of the conversations in the chronological order in which they occurred?

The Witness: I might.

The Court: I take it we are at the first conversation.

Mr. Williams: Yes.

Q. Can you remember what was said the first time you talked with Mr. H. M. Warner on that subject?

A. Without remembering a date, the first conversation with Mr. Warner was: What do I think of Milton Sperling becoming connected with our company in a production capacity? [1305] And in

(Testimony of Samuel Schneider.)

our business the most important thing in our business is production of motion pictures. We are constantly discussing that subject, as we are discussing the subject today.

When Mr. Warner spoke to me about Milton Sperling, I knew prior to his conversations about Mr. Sperling what his business had been, what his experience had been, what pictures he had produced, what work he did at other companies.

After discussing the matter with Mr. Warner I discussed the matter with other executives in our company so I can form a better opinion as to how Mr. Sperling would fit into our company.

Q. Did you answer Mr. Warner at once when he asked you what you thought of having Milton Sperling come in in a productive capacity or production capacity? Did you answer him at once, or did you answer him later?

A. At the beginning we had a general discussion and——

Q. What I am trying to get at is: What did Mr. Warner say to you and what did you say to him?

A. The substance of the conversation was: What do I think of Milton Sperling becoming connected with our company in a production capacity. My answer was, and it would be the same with any other person that he would suggest, and that is that if the person has the ability and the company can work out the proper deal, that it might be the right thing for our company. [1306]

(Testimony of Samuel Schneider.)

And subsequent to that I discussed the matter with other executives of our company, as we usually do in our business, and in subsequent conversations with Mr. Warner and other executives we developed the idea of Mr. Milton Sperling becoming connected with our company in a production capacity.

Q. After you first talked with Mr. Warner with what other executives of the company did you discuss the matter of Mr. Sperling becoming associated in a production capacity?

A. The most important two people that I discussed a matter of this kind would be Jack Warner and our salesmanager, Mr. Kalmenson. And I had many conversations with those two individuals on this matter.

Q. Have you given us the substance of the first conversation you had with Mr. H. M. Warner?

A. Yes.

Q. Can you remember the next time you talked with him on the subject?

A. I couldn't fix any dates, as I said.

Q. I understand that, but can you remember the fact of your having a second conversation on the subject?

A. Yes. I had many conversations and, as I said, they were during my visits to the Coast, during his visits to New York, and on the telephone. And in subsequent conversations we went more deeply into the matter as to how he could be connected with our company, in what capacity. [1307]

(Testimony of Samuel Schneider.)

Q. What was said by Mr. Warner and what was said by you on that subject?

A. Well, I could best summarize Mr. Warner's conversations to me by saying that he suggested that Milton Sperling be connected with our company in a production capacity. At the beginning there were no details as to what capacity that might be, and we discussed the possibility of him coming in as a producer or as assistant to Jack Warner, or in some sort of a setup, as we have in our business, of a producing unit producing pictures which would be distributed through our company. And, as I discussed the matter with other executives in our company, Mr. Jack Warner, Mr. Kalmenson and others, as we went along we developed the plan until it was finally finalized into the form that we made the agreement.

Q. During those conversations did you talk with Milton Sperling about the subject at all?

A. Oh, yes.

Q. When did you first talk to Milton Sperling about it?

A. Well, I could not fix the date but it was sometime prior to the signing of this contract I had a few conversations with him.

Q. Then do you remember about how long it was before the contract was signed?

A. No, I couldn't.

Q. I will ask you this: At the time the contract came up before the Board of Directors for action you were in New York, were you? [1308]

(Testimony of Samuel Schneider.)

A. No.

Q. Were you at that time on the Coast?

A. Yes.

Q. And had you been on the Coast for some time then? A. About two weeks, I would say.

Q. During——

Mr. Levy: Pardon me. May we have the record clear on the subject? He said "at the time the matter came on for action by the board of directors." You refer to September 28, 1945?

Mr. Williams: Yes.

Q. You so understood, did you, that I was talking about September 28, 1945, when the board acted on this contract?

A. I was not in New York on the day that the contract was approved by the board.

Q. Yes.

A. I know that because I looked it up.

Q. Mr. Schneider, you say you had been on the Coast, by which I suppose you mean you had been at the offices of the company out in Burbank and out here generally in connection with the business of the company for about two weeks prior to that date, September the 28th? A. Yes.

Q. During that time had you seen Milton Sperling and [1309] talked with him about the matter?

A. I couldn't remember.

Q. You have spoken of having talked with Mr. H. M. Warner and how this subject was developed. Do you know who first suggested, as far as your knowledge goes, who first suggested that the matter

(Testimony of Samuel Schneider.)

of having Milton Sperling connected with the company should be in the form of a separate producing company or separate producing organization to make pictures for Warner's distribution?

A. To the best of my recollection, that was a result of a number of conversations between various people. I couldn't recollect who made the suggestion, specifically.

Q. What persons do you refer to when you say conversations among various people?

A. Harry Warner, Jack Warner, Albert Warner, myself, Mr. Sperling, Mr. Joe Bernhard.

Q. Do you remember when it was that Mr. Joe Bernhard's name first came into the discussion in connection with this matter of Milton Sperling becoming connected with the Warner organization?

A. Well, during my conversations with Mr. Warner Mr. Bernhard's name was also suggested as a possible man to—well, Mr. Bernhard's name was suggested at the time that it was decided that a unit would be set up.

Q. And it was Mr. H. M. Warner who first mentioned Mr. [1310] Bernhard's name to you, was it?

A. I would imagine that it was.

Q. Did you talk with Mr. Bernhard on that subject? A. Yes.

Q. And how many talks did you have with him?

A. I had a few talks with him in New York.

Q. What was the substance of what you and he said to each other on the subject?

A. Well, Mr. Bernhard and myself, we worked

(Testimony of Samuel Schneider.)

closely together, and he discussed with me the possibilities of being connected with a unit to produce pictures at our studios. He asked my opinion of it. He asked what I thought would be the possibilities of such a unit in the future. I gave him my opinion. I told him.

Q. What did you tell him?

A. I told him that the most important function in our company is the making of motion pictures; that, from my experience, the people, business people who had experience in running theatres, such as Mr. Bernhard had, and an all-around experience as to the public's taste for pictures would be a very important adjunct to a production unit. I base that on the knowledge that in other companies, specifically Paramount, that——

Mr. Levy: May I interrupt at this time? I think the witness is going beyond the purview of the question and [1311] what he is about to testify appears very plainly to be not responsive to the question.

Q. (By Mr. Williams): I do not know how much of this you said to Mr. Bernhard or how much you did not, but confine yourself to what you said to Mr. Bernhard on the subject, Mr. Schneider.

A. I told Mr. Bernhard that the most important function in our business was the production of motion pictures. That the knowledge of a man of his caliber and his experience would be very important in a producing unit. And I told him that there was

(Testimony of Samuel Schneider.)

a very good future in an enterprise of that kind and it would be very good for our business.

Q. You have spoken of your discussions with Harry Warner and Jack Warner and Mr. Sperling and Mr. Bernhard. What was the substance of your discussion with Mr. Kalmenson on this subject?

A. I discussed with Mr. Kalmenson, who is our sales manager, the possibility of a man like Milton Sperling being connected with our company, and then the possibility of a producing unit being set up which would produce pictures for our company. And we discussed between ourselves that it would be a good thing for our company because an independent unit is able to attract outside talent. And Mr. Kalmenson is always willing for a unit of that type to be set up, so that we would obtain motion pictures. [1312]

Q. What did he say with reference to this particular matter of a unit involving Joseph Bernhard and Milton Sperling, as to whether he was favorable or unfavorable to that particular setup?

A. Well, he thought like I did, that with Mr. Sperling's ability and Mr. Bernhard's ability, that they could set up a production unit that would attract talent and would make a caliber of picture which would be beneficial for our company.

Q. What was the situation with reference to what number, or the pictures that you had available at that time? In other words, what I am getting at is: Was Warner Bros. in such a condition that

(Testimony of Samuel Schneider.)

it was desirable that you should have more product than you were getting at the time?

Mr. Levy: I object to the question on the ground that it calls for a conclusion. I have no objection to the witness relating the Warner inventory at the time, though I think the question calls for a conclusion.

Mr. Williams: Inventory is meaningless.

The Court: Overruled. You may cross examine him on the conclusion if you are so advised. You may answer. [1313]

The Witness: The condition in a motion picture company such as ours is always at a point where we need product. It is not a question of whether at that time we had a sufficient number of pictures to release that year. It was a question of how will we get the next batch of pictures, and we are constantly seeking producer or production contracts, stars, directors, stories, and we are always in search for mediums to obtain motion pictures.

Q. At that time how many exchange centers or exchanges did Warner Bros. operate in the United States? A. About 35.

Q. How many theatres in the United States were served by those exchanges?

A. Over 400.

Q. I am not talking about Warner theatres; I am talking about theatres as a whole.

A. I would say anywhere from fifteen to eighteen thousand.

(Testimony of Samuel Schneider.)

Mr. Levy: May we have a definition of what "as a whole" means?

Mr. Williams: I mean all theatres in which they show licensed pictures.

Mr. Levy: You mean theatres other than theatres owned by Warner Bros. Pictures?

Mr. Williams: Certainly; that is what I am talking [1314] about.

Q. You understood me, didn't you, that I was talking about theatres in which Warner Bros. licensed pictures? A. Yes.

Q. Including their own theatres? A. Yes.

Q. How many theatres in the United States were owned by Warner Bros. at that time?

A. Over 400.

Q. In foreign countries did Warner Bros. have distribution organizations? A. Yes.

Q. In how many foreign countries, approximately? A. Over 40.

Q. In England or in the United Kingdom, specifically, did Warner have additional distribution organization? Did it have an interest in theatres?

A. Yes; we own 37½ per cent of a circuit of theatres, over 400.

Q. In the United Kingdom? A. Yes.

Q. Did Warner own theatres in any other countries outside of the United States and the United Kingdom?

A. At that time we had a few. [1315]

Q. I am referring always, Mr. Schneider, to before the 2nd of March of this year, before there

(Testimony of Samuel Schneider.)

was a complete disposition of Warner theatres under a decree of the Federal Court. A. Yes.

Q. And this situation, concerning which you have been testifying, is the situation that existed in 1945? A. Yes.

Q. Prior to September 28, 1945, as has been shown here in this case in evidence, Warner Bros. had made several production-distribution contracts with several different organizations.

Were you aware of that fact at that time?

A. Yes.

Q. Were you aware of the fact that they had first made the Cosmopolitan contract back in 1936?

A. Yes.

Q. And later the Capra and the Bette Davis and the other contracts that have been shown in evidence here? A. Yes.

Q. Was it at that time your opinion that the making of production-distribution contracts as a method of obtaining pictures was of advantage to Warner Bros.?

Mr. Levy: May we have an expression from Mr. Williams as to what he means by "at that time," specifically? [1316]

Mr. Williams: The time I have been talking about.

Mr. Levy: Namely?

Mr. Williams: September, 1945.

The Witness: Every contract that we ever went into, we did it with the knowledge, or we did it

(Testimony of Samuel Schneider.)

with the thought that it would be to the benefit of the Company.

Q. (By Mr. Williams): That is not answering my particular question.

My question was: In September, 1945, was it your then opinion that the making of contracts with independent producers, that method of obtaining product for distribution by your company was of advantage to Warner Bros., that type of contract? A. Yes.

Q. In addition to talking this matter of the proposed agreement over with Sperling and Bernhard, with M. H. Warner and the other persons you have mentioned, did you talk over the matter with Mr. Friedman? A. Yes.

Q. With Mr. Perkins?

A. I might have.

Q. Did you discuss the matter with Mr. Carlisle? A. Yes.

Q. Mr. Carlisle is the head of the accounting department, is he not? [1317]

A. Yes; he is the controller.

Q. Do you remember any other persons with whom you discussed the matter?

A. I might have discussed the matter with Mr. Freston. I am not sure, though.

Mr. Levy: May we have some indication of the time that the witness has referred to, when he discussed the matter with Mr. Freston?

Mr. Williams: If the witness can remember.

(Testimony of Samuel Schneider.)

The Witness: Prior to the signing of the contract.

Q. Can you fix it any more definitely than that?

A. No. I might have discussed it with other people of which I am not sure, like Mr. Trilling in our studio, and Mr. Obringer.

Q. Mr. Trilling has what position?

A. He is the assistant to Jack Warner.

Q. And Mr. Obringer?

A. He is in our legal department.

Q. Is it your recollection you did discuss it with those men? A. I wouldn't be sure.

Mr. Levy: When you say "it," was "it" referred to in the question concerning the desirability of having Sperling come into the organization?

Mr. Williams: It refers to what I was asking about, [1318] the deal with Sperling and Bernhard to make pictures.

Mr. Levy: I see.

Q. (By Mr. Williams): Mr. Schneider, did you see the contract that was finally signed, or what purported to be a draft of it, at any time before it was signed, that is, the actual contract itself?

A. I couldn't recall.

Q. What was your understanding at that time as to what the terms of the contract were?

A. I knew——

Mr. Levy: May we have the time again fixed?

Mr. Williams: I just got through saying "at the time of the signing."

(Testimony of Samuel Schneider.)

Mr. Levy: At the time of the signing?

Mr. Williams: Yes; at the time of the signing. I just got through saying it.

Do I have to keep saying it in every sentence?

Mr. Levy: No; sorry.

The Witness: I was familiar with all the terms, of course, prior to the signing.

Q. (By Mr. Williams): State to the best of your recollection what you now remember the terms were.

Mr. Levy: I move to strike the answer of the witness on the ground it is a conclusion.

Well, I will withdraw the motion. [1319]

Q. (By Mr. Williams): State, as nearly as you can now remember, what you then knew in detail as to what the terms of the contract were.

A. The final terms of the contract, as I remember them, and as I know them now, were that United States Pictures would produce six pictures in a period of three years; Warner Bros. Pictures would put up 50 per cent of the money, United States Pictures would put up 50 per cent of the money; Warner Bros. Pictures would receive 20 per cent for domestic distribution, 25 per cent for distribution in the United Kingdom, and a schedule of distribution charges in the other foreign countries; that Warner Bros. would charge to the cost of production 30 per cent of its production facilities, and 18 per cent of the facilities furnished by United States Pictures; which formula was arrived at by Price, Waterhouse.

(Testimony of Samuel Schneider.)

Warner Bros. Pictures would advance the cost of prints, advertising and other charges.

That when the pictures were distributed, we would deduct our distribution charges and the other charges that I mention.

The next money would be paid toward the United States Pictures' 50 per cent advance for production. The next money we would deduct as our advance for production, and the balance would be divided 50-50. [1320]

Also that United States Pictures would endeavor to obtain stories, personalities, without which they couldn't produce pictures; that we could recoup any losses from subsequent pictures, and in the event there was a loss not recouped, that at the end of four years after the release date of the final picture, United States Pictures would pay us the difference.

Q. Have you now related what you remember as to your then knowledge of the contract?

A. Yes.

Q. Was it your opinion at that time that that contract was favorable to the business interests of Warner Bros.? A. Yes.

Q. What advantages, if any, are there to a studio like Warner Bros. having an independent producing unit within the studio?

A. The greatest advantage, as we look on it, is that they are able to obtain the services of stars, directors, writers: they are able to obtain stories. Warner Bros. are always in a favorable position

(Testimony of Samuel Schneider.)

with a contract of that type because they absorb part of our overhead. We obtain the distribution charges. We also use other facilities of our organization, such as checking theatres, and our prints which are furnished by [1321] our laboratory, so that we absorb the overhead charges in our laboratory. The use of our music and our music companies, and also the ability to obtain pictures, which we are always trying to get, playing the pictures in our own theatres, which gives us a profit in our theatres. And the all-around benefits of a unit of that type are very large.

Q. Mr. Schneider, since the making of the contract which has been marked Exhibit 1 in this case, have you, yourself, kept track of how the operation of it has worked out? A. Yes.

Q. Have you observed what pictures have been produced and the results generally from those pictures?

A. Yes; that is one of my important functions with the company.

Q. In the performance of that function, you have kept your eye on what has happened as a result of making this contract? A. Yes.

Q. What pictures have been produced?

A. They produced eight pictures and are producing a ninth.

Q. And are producing a ninth? A. Yes.

Q. Do you know, generally, about what the financial [1322] results of the production of those pictures have been? A. Yes.

(Testimony of Samuel Schneider.)

Q. Will you state what they are from the viewpoint of Warner Bros.? A. Yes.

Mr. Levy: The question is objected to on the ground it calls for the conclusion of the witness.

Mr. Williams: No; it is not. It is calling for the knowledge of this man, whose business it is to keep track of these matters.

Mr. Levy: You mean he is to give us his knowledge of this whole transaction in one breath?

Mr. Williams: Yes.

The Court: The objection is overruled. You can cross examine as fully as you wish, if so advised.

You may answer.

The Witness: There were eight pictures produced by United States Pictures. Seven of them have either shown a profit or will show a profit, based on the terms of the contract.

The over-all profit of the seven pictures, I would say, would be about three and a half million.

The loss on the one picture, My Girl Tisa, a million two, bring the net profit approximately over two million dollars. [1323]

The Court: Is that the net profit to the corporation, Warner Bros.?

The Witness: No, the net profit of the pictures entirely, about two million dollars. Under the terms of our contract, we would receive about a million and a half dollars of that profit and United States Pictures about half a million dollars.

Besides that, our company will receive between

(Testimony of Samuel Schneider.)

five and a half million and six million dollars in distribution charges.

We will receive over three and a half million overhead charges of the studio.

The profits in our own theatres would be upward of a million dollars.

So that the total benefits to our company, in my opinion, would be in excess of eleven million dollars.

Mr. Levy: May I move the answer of the witness be stricken, if the court please, on the ground it is a conclusion of the witness; is incompetent, irrelevant, and immaterial to establish the fact, namely, the profit that Warner Bros. has made over-all, the profit that Warner Bros. has made as the result of overhead, as the witness expressed it, and the profit Warner Bros. has made as the result of exhibition, as the witness has expressed it; and in every respect in which the witness [1324] used the word "profit."

I respectfully submit his whole answer is a conclusion on the part of the witness, and is not the best evidence in the case.

Mr. Williams: We resist the motion, your Honor.

The Court: Motion denied.

Q. (By Mr. Williams): Mr. Schneider, I direct your attention to the fact that there was an amendment to the United States Pictures contract, the basic agreement, and, incidentally, in questioning you further, in order to save ourselves time and words, when I speak hereafter of the basic agree-

(Testimony of Samuel Schneider.)

ment I will mean the agreement dated September 28, 1945, between United States Pictures and Warner Bros.

The Court: Exhibit 1 here.

Mr. Williams: Exhibit 1 in this case.

Q. Now, are you aware of the fact that there was an amendment dated May 20, 1946, which is marked Exhibit 3 in this case, and which had to do with the Hemisphere Pictures? A. Yes.

Q. Prior to the making of that contract, did you know anything about it? A. I did.

Q. From whom did you first learn of that matter? [1325]

A. From Milton Sperling.

Q. Were you in New York or California, or where?

A. I couldn't remember. I recall I had a long telephone conversation with Mr. Sperling.

Q. What was the substance of the conversation you had with Mr. Sperling on that subject?

A. He told me that there was a possibility of obtaining the story Pursued, written by Niven Busch, starring his wife, Teresa Wright, and he thought that this would be a good picture to make, that Jack Warner thought it was a good property, but in order to obtain that project that he would have to make a deal with them on some sort of a percentage basis.

Q. Did he tell you further what the percentage was or what the details of the basis were?

(Testimony of Samuel Schneider.)

A. Yes; he discussed approximately some of the details.

Q. Tell us, as well as you can remember, what details he gave you.

A. They would want a percentage of the profits, and I don't recall exactly what the details might have been, but I do know what the final deal was after discussions.

Q. We will get to that later. What did you say in response to his statement to you that some sort of a [1326] profit-sharing deal would have to be made?

A. I told him if a deal could be worked out, that we would feel would be beneficial for our company, "By all means make it."

Q. Thereafter, did you have further discussions with him or with any other person about this proposed Hemisphere deal before it was finally consummated? A. Yes.

Q. With whom did you discuss it?

A. I discussed it with Jack Warner, Milton Sperling, and the sales manager.

Q. That is Mr. Kalmenson? A. Yes.

Q. What was the substance of the conversation you had with Mr. Jack Warner on the subject?

A. What did he think of the property Pursued, starring Teresa Wright.

Q. What did he say, is what I am asking you.

A. He thought it was a very good story and could be made into a good picture.

(Testimony of Samuel Schneider.)

Q. The substance of your further conversation with Milton Sperling was what?

A. At the time that he worked out the final details or possible deal——

Q. No; what did he say to you? [1327]

A. He told me the final terms.

Q. What did he tell you?

A. He told me that the profit would have to be split one-third to those people, one-third to United States Pictures, and one-third to Warner Bros.

Mr. Levy: By "those people," does the witness mean Niven Busch and Teresa Wright?

The Witness: Yes.

Q. (By Mr. Williams): What else did he tell you?

A. He told me in endeavoring to work out the terms, they worked out certain terms, and United States Pictures would charge this unit, and whatever the difference would be between what we charged United States Pictures and they charged the other company would be split 50-50 between us.

Mr. Levy: Does the witness mean Hemisphere when he says "the other company"?

Mr. Williams: Of course he does.

Mr. Levy: I just want the record clear.

The Court: Address your remarks to the court, gentlemen, and let us have no more bickering between you.

Mr. Levy: May I ask at this point, in order to clear the record, that the witness, in designating this other person, is speaking of Hemisphere, so

(Testimony of Samuel Schneider.)

we will be clear on the subject? Then I won't have to cross examine on the [1328] subject, if the witness will actually say so-and-so. That is the reason for the interruption.

Q. (By Mr. Williams): Had you completed your answer?

A. He told me that they would charge——

The Court: You see, "'they' 'is very indefinite.

The Witness: Yes. Milton Sperling told me that United States Pictures would charge Hemisphere 25 per cent for domestic distribution, 30 per cent in Great Britain, and the same schedule of percentages in the foreign countries as we were charging United States Pictures, and they would charge them a larger amount for the overhead of the studio, which I think was 45 per cent.

Then I proceeded to calculate as to what that would mean to our company, the fact that we would get 22½ per cent domestic and the 27½ per cent in Great Britain and half of the overhead charges between the 30 and 45 per cent, and by a quick calculation I told Milton Sperling that those terms were as satisfactory to Warner Bros. Pictures as if the picture was made by United States Pictures.

Q. (By Mr. Williams): What was the substance of your conversation with Mr. Kalmenson on the subject of this proposed Hemisphere deal?

A. I merely discussed with Mr. Kalmenson the possibility of the company obtaining a picture called Pursued, written by Niven Busch and star-

(Testimony of Samuel Schneider.)

ring Teresa Wright, [1329] and he thought it was a good thing to get that picture.

Q. What was the reason you discussed these things with Mr. Kalmenson?

A. Mr. Kalmenson is our sales manager, who is constantly traveling throughout the United States. He knows the pulse of the public, and he is constantly talking with exhibitors, and he is best qualified in our company to pass an opinion as to whether a certain picture, starring certain people, would be good box office.

Q. What was your opinion when the contract was finally presented to the Board of Directors; when the United States Pictures deal was finally presented to the Board of Directors, what was your opinion as to whether or not it was a contract for the benefit of Warner Bros.?

A. Do you mean the——?

Q. The Hemisphere amendment to the basic agreement, and by the Hemisphere amendment I am referring to Exhibit 3 in this case.

A. I thought it was satisfactory.

Q. You were present at the meeting of the Board which approved that contract, were you not, on June 18, 1946?

A. I wouldn't remember.

Q. You don't remember?

A. No. If the records show I was there—but I [1330] couldn't remember.

Q. At any rate, whether you remember being

(Testimony of Samuel Schneider.)

there or not, you personally did approve the contract? A. Yes.

Q. I call your attention to the fact that under date of July 21, 1950, there was another amended or supplemental agreement executed between United States Pictures and Warner Bros. which has been marked in evidence in this case as Exhibit 7.

The Court: Do you wish the document placed in front of the witness?

Mr. Williams: Yes. May the document be placed in front of the witness?

The Witness: I am familiar with the document.

The Clerk: Did you say No. 7, Mr. Williams?

Mr. Williams: I think, if your Honor please, I will withdraw that at this time and go to the December 6 agreement, which is Exhibit 4.

In looking here, I passed up that particular exhibit.

May the witness have placed before him Exhibit 4?

Q. Mr. Schneider, I call your attention to Plaintiff's Exhibit 4 in this case, an agreement in the form of a letter dated December 6, 1947, and which is the agreement which we referred to here yesterday, and one which provides for additional pictures, and extends the [1331] time for the making of original pictures.

Prior to the execution of that agreement, did you have any conversation with any person or persons concerning the matter of deferring the making of further pictures under the basic agreement and the

(Testimony of Samuel Schneider.)

matter of having an arrangement for the making of additional pictures? A. Yes.

Q. With whom did you first discuss that subject?

A. I wouldn't remember who I first discussed it with, but I know I discussed it with Milton Sperling, Jack Warner, Harry Warner, Albert Warner, and our sales manager.

Q. You cannot remember who it was that you first discussed it with? A. No.

Q. Can you tell us what the substance of the conversations you had with Milton Sperling was?

Mr. Levy: May we have the time, your Honor, approximately fixed?

Q. (By Mr. Williams): If you can do so, fix the time, Mr. Schneider.

A. It was prior to the signing of the contract. I couldn't possibly fix the exact time. I would say maybe a few months before.

Q. You did then talk with Milton Sperling?

A. Yes. [1332]

Q. Did you talk with him more than once on the subject? A. Yes.

Q. About how many times did you discuss the matter of this proposed contract with Milton Sperling before the contract was executed?

A. It was more than once.

Q. Can you give us the substance of what was said by Milton Sperling and what was said by you in those conversations?

A. I recall that he asked my opinion as to the

(Testimony of Samuel Schneider.)

advisability of continuing on the basis of the original contract, which called for the borrowing of money at the bank. In view of the falling box office receipts in the theatres, he expressed a reluctance about making the next picture under that method, and borrowing money from the bank. [1333]

Q. What did you say to that?

A. I advised him about the condition of the picture business and told him that box office receipts were falling and that there was a risk in borrowing money from the bank at that moment and making a picture. It was a general conversation between the two.

Q. Was anything said at that time on the subject of making pictures for Warner on a different basis? A. Yes.

Q. What was said and by whom?

A. Well, specifically, with Milton Sperling. He desired to make pictures and the company wanted him to go ahead and make pictures. He had stories prepared. He had an organization. We wanted pictures and we discussed generally the possibility of making pictures by United States Pictures on a different basis.

Q. Was anything said between you as to what that different basis would be?

A. We discussed generally a possible modification of the contract.

Q. Did you go into any detail as to who would finance the pictures?

A. Well, I couldn't say that it was at the first

(Testimony of Samuel Schneider.)

conversation with Mr. Milton Sperling but after discussing the matter with other people in our organization, I was [1334] prepared and did talk to Milton Sperling about a modification of the contract under another basis.

Q. All right. Now, let's just leave Mr. Sperling for the moment. After you first talked with Mr. Sperling with whom did you discuss the subject of a possible change in the contract?

A. With Jack Warner, with Harry Warner, with Mr. Kalmenson, with Mr. Albert Warner, with Mr. Carlisle.

Q. What was the substance of your conversation or conversations with Harry Warner on that subject?

A. Along the same line and about the——

Q. Just tell us as nearly as you can remember what he said and what you said.

A. About the fact that, with the falling box office receipts, the risk involved in United States Pictures borrowing 50 per cent of the production cost of a picture from a bank at that time, our opinion was at that time that box office receipts would fall more drastically and that the condition of business would be even worse than subsequently the case was. And I discussed with Mr. Harry Warner that we were discussing a different form of a contract.

Q. What did he have to say as to that?

A. Well, he didn't participate in any talk about what terms we could fix. Usually in a case of that

(Testimony of Samuel Schneider.)

kind Mr. Warner relies on the other executives of the company to come [1335] up with terms and conditions of a contract that would be satisfactory to our company.

Mr. Levy: May I move to strike the latter part of the witness' answer?

Mr. Williams: We think it is within the issues, your Honor. The fact it is not responsive to the particular question——

Mr. Levy: It is not responsive. He was asked what he discussed with Mr. Warner, what did Mr. Warner say to him in substance and what did he say to Mr. Warner. I have no objection to the rest of the answer, but the last part of the answer is a departure from the point of the question.

Mr. Williams: We admit that, your Honor, but it is admissible as being relevant to the issues involved.

The Court: It is a statement as to proof.

Mr. Levy: I do not press the objection.

The Court: Motion denied.

Q. (By Mr. Williams): Where were you? Do you remember? A. Yes.

Q. Proceed.

A. In a matter of this kind when there is a discussion between the executives, Harry Warner would leave the terms, the detail of the working out of a contract to his executives.

Q. In this particular case, then, as I take it from your testimony, Mr. Harry Warner did not

(Testimony of Samuel Schneider.)

discuss with you any [1336] of the details of this proposed change? A. I don't think so.

Q. Yes.

A. I might have advised him about the final contract.

Q. With reference to your conversation with Jack Warner, you talked this matter over with him, that is, the matter of a proposed different arrangement for the making of additional pictures?

A. Yes.

Q. What was the substance of the conversation you had with Jack Warner? What did you say and what did he say?

A. I discussed with Jack Warner the point that Milton Sperling raised about the advisability of borrowing money at that time and the advisability of United States Pictures going ahead and making pictures on a different basis. Jack was satisfied to do that if the right deal could be worked out.

Q. And you say you talked it over with Mr. Kalmenson? A. Yes.

Q. What was the substance of your conversation with Mr. Kalmenson?

A. Merely that we were trying to work out a deal with United States Pictures whereby they would continue to produce pictures on a different basis. Mr. Kalmenson would not be interested in the various terms under the contract, other than the fact that they would produce pictures and the distribution [1337] terms.

(Testimony of Samuel Schneider.)

Q. Did you discuss the distribution terms with him? A. Yes.

Q. What did you say to him and what did he say to you with reference to distribution terms under the proposed agreement?

A. I discussed that with Mr. Kalmenson after we had arrived at some sort of a basis.

Q. And what was the substance of that conversation?

A. I advised Mr. Kalmenson that under a new contract we were proposing that the distribution terms domestic would be 25 per cent instead of 20, that the United Kingdom terms would be 30 instead of 25, and that we would receive the various schedule of percentage throughout the world in other countries.

Q. Now, having this——

Mr. Levy: May it please the court the answer of the witness who said: "I advised Mr. Kalmenson" of these facts, namely, the distribution percentages, after we had arrived at the terms, may the witness at this time state, in order to save time on cross examination, whom he meant by "we"?

The Court: Yes.

A. Mr. Sperling, myself, and after having discussed the matter with Jack Warner or Harry Warner.

Mr. Williams: I was going to have that. [1338]

Q. After you had discussed the matter with Harry and Jack Warner and other persons you mentioned did you have a further conversation with

(Testimony of Samuel Schneider.)

Milton Sperling at which a deal was agreed upon?

A. Yes.

Q. Just state the substance of that conversation.

A. We discussed the final terms of a deal, which were that Warner Bros. Pictures would advance 100 per cent of the production cost; that under the new deal it would not be — under the new deal United States Pictures would use more of the facilities of Warner Bros. Pictures' studios; that the overhead charge would be our regular overhead charge which we charge to all pictures; and that the distribution terms would be 25 per cent domestic and 30 per cent in Great Britain and various schedule in other foreign countries; and that we would still advance the cost of prints, advertising and other charges, and the net profits would be divided 80 per cent to Warner Bros. Pictures and 20 per cent to United States Pictures.

And also during the conversation we discussed the fact that we would keep the profits of the additional pictures to recoup any losses on any previous pictures under our original contract.

The Court: We will take the morning recess at this time.

(Short recess.) [1339]

Q. (By Mr. Williams): I don't remember whether you had testified, Mr. Schneider, but do you remember whether you were present at the time that—I withdraw that question.

At the time that you gave your approval to the terms of what became the agreement of December

(Testimony of Samuel Schneider.)

6, 1947, Exhibit 4 in this case, was it your opinion at that time that that was for the benefit of Warner Bros. Pictures, Inc.? A. Yes.

Q. I now call your attention to Exhibit No. 7 in this case. The clerk is handing you the exhibit, which you will observe is an agreement dated July 21, 1950 between United States Pictures and Warner Bros. Prior to the time that that agreement was executed were you aware of the fact that such an agreement was in contemplation and was being discussed? A. Yes.

Q. Did you discuss it with any person or persons? A. Yes.

Q. With whom did you discuss the matter of this proposed agreement?

A. It was practically the same procedure as the previous contract; with Milton Sperling, with Jack Warner. There wasn't too much discussion because it was merely another postponement of the making of the original pictures and the addition of three additional pictures. So the conversations were practically along the same line. [1340]

Q. Do you remember in connection with that talking to Mr. Obringer about it?

A. I might have.

Q. Do you remember whether or not you instructed Mr. Obringer to draw a contract providing for this extension of time and additional pictures?

A. I might have instructed him.

Q. Do you have any recollection of it now as to whether you did or did not?

(Testimony of Samuel Schneider.)

A. No, I don't.

Q. You were, however, aware of the fact that such a contract was to be drawn, and did you approve of it? A. Yes.

Q. Did any of the persons with whom you discussed the matter voice any disapproval of this additional contract Exhibit 7?

A. Not that I recall.

Mr. Levy: Pardon me, may it please the court. May the witness at this time name the persons that are referred to in the previous question?

Q. (By Mr. Williams): Just give the names of the persons to whom you talked about this contract. You have named them once.

A. Mr. Sperling.

Q. Any other person? [1341]

A. Jack Warner, our sales manager, but I couldn't recall specifically whether I spoke to each one that I named in the previous contract.

Q. You do remember these three?

A. Oh, yes.

Q. That is, Mr. Sperling, Jack Warner, and Mr. Kalmenson? A. Yes.

Q. And, as I understand, you don't remember whether you did or did not instruct Mr. Obringer to draw the additional agreement?

A. I don't remember.

Q. At the time that you discussed this matter did you believe that it was a good thing for Warner Bros., it was for the benefit of Warner Bros. that those terms should be additionally extended

(Testimony of Samuel Schneider.)

and provision should be made for the making of additional pictures? A. Yes.

Q. Were you present at the meeting of the board of directors when the contract of July 21, 1950 was presented to the board for approval?

A. I don't remember.

Q. You do not remember whether you were or were not before the board?

A. That is correct. [1342]

Q. But whether you remember being before the Board or not, you did favor the contract?

A. Yes.

Q. There has been received in evidence in this case a contract dated August 12, 1952, which is Exhibit H, attached to Exhibit 107. I think without the necessity of bring that out, I can fully describe it. That is the agreement which provides for the making of two additional pictures and extends the time for making the original pictures under the basic agreement. Are you familiar with that?

A. Yes.

Q. Was that matter discussed with you before the contract was made?

A. Yes.

Q. With whom did you discuss it?

A. I discussed it with Milton Sperling.

Q. And with any other person or persons?

A. With Jack Warner.

Q. What was the substance of the conversation with Milton Sperling on that subject?

A. Just merely the advisability of continuing

(Testimony of Samuel Schneider.)

the production of motion pictures under the same terms as the additional pictures.

Q. What did he say and what did you say on that [1343] subject?

A. He merely would discuss with me what was my opinion of making a picture at that time under the original agreement and borrowing money at the bank. We had a general discussion about conditions in the business and the risk to be taken at that time in the borrowing of money from the bank, and Warner Bros. desiring to continue the receiving of pictures from United States Pictures, if it was possible for them to produce them; and we agreed to continue the contract.

Q. Did you think at that time that was for Warner Bros.' benefit? A. Yes.

Q. Did you discuss the matter with Jack Warner also? A. Yes.

Q. What was the substance of that discussion?

A. Any matter of this type I would discuss with Jack Warner, because we would discuss the properties that United States Pictures has; I would ask Jack Warner what was his opinion of whether United States Pictures could in the next year or so make a picture or two, what does he think of the story that United States Pictures was preparing, and I would obtain from him the opinion as to whether the United States Pictures were in a position to produce additional pictures for our company to [1344] distribute.

Q. What did he say as to that?

(Testimony of Samuel Schneider.)

A. He thought that, after describing the different stories that they were working on and who would be in the cast, he agreed we should extend it so that they could proceed with production.

Q. Do you remember the names of any of the particular pictures he discussed at that time that were in preparation? A. Yes.

Q. What pictures?

A. I remember specifically that we discussed the picture Three Secrets. I remember discussing the picture Distant Drums, which would be made in Florida with Gary Cooper. We discussed the picture The Enforcer, which was based on the story Murder, Incorporated; and Jack always knew the properties that United States Pictures had, and whether or not it was worth while for them to proceed with production.

Mr. Levy: Pardon me, Mr. Williams. May it please the court, I think there is a slight confusion in the record.

Mr. Williams: We will take care of the confusion in the record, Mr. Levy.

Mr. Levy: May I indicate what I thought the confusion is to your Honor? [1345]

The Court: You may.

Mr. Levy: Mr. Williams' question to the witness was to the effect, or was designed to bring out from the witness what he had discussed with Milton Sperling at or about August 12, 1952, and I believe the witness misunderstood him, because he went back to the years 1948, 1949 and 1950.

(Testimony of Samuel Schneider.)

I say that creates a confusion in the record; and, to save time on asking a lot of preliminary questions on cross examination on this particular subject, I thought it might be cleared up at this point.

Mr. Williams: That is what I was just about to do, except that counsel is also in error. I was not asking the witness about a conversation with Milton Sperling; I was asking the witness about a conversation with Jack Warner.

Q. The conversation I am now asking you about, Mr. Schneider, is a conversation in August of 1952 when this last extension was made, and the question was, Do you remember now what picture or pictures were discussed as being in preparation at that time?

A. My former answer was based on the many conversations I had with Jack Warner. In 1952 we specifically discussed the very picture he is working on now, Blowing Wild; the story we discussed, [1346] Retreat, Hell, which I don't recall whether it was at the time of this renewal of the contract, but I remember specifically discussing with Jack Warner the story Retreat, Hell, which was based upon events in Korea, and which we were very anxious to get. We thought it was a very timely subject.

Q. Are you familiar with the fact that as late as February of this year an additional amendment of the contract was made providing for the making of the picture Blowing Wild in Mexico, instead of at the Warner Studios? A. Yes, sir.

(Testimony of Samuel Schneider.)

Q. Were you familiar with the fact that contract was in process of being negotiated while it was being negotiated? A. Yes.

Q. Did you approve of that contract as being beneficial to Warner Bros.? A. Yes.

Mr. Levy: May it please the court, I did not get Mr. Williams' question just before the last one. The witness answered "Yes," and the next question came in before I could interrupt. May I call upon the reporter to read the question before the last one Mr. Williams put to the witness?

The Court: Will you do so, Mr. Reporter?

(Record read.)

Mr. Levy: The last question is rather confusing, your Honor. We don't know whether it points to terms that were being discussed or the contract that was ultimately negotiated, and I object to it on the ground it is improper in form.

The Court: Do you make a motion that the answer be stricken?

Mr. Levy: I make a motion the answer be stricken, may it please the court.

The Court: The motion is granted, and the objection is sustained.

Q. (By Mr. Williams): Are you familiar with the terms of the agreement as finally drafted?

A. Yes.

Q. The agreement of February 11, 1953?

A. Yes.

Q. Did you approve of that agreement?

A. Yes.

(Testimony of Samuel Schneider.)

Q. In your opinion is that agreement for the benefit of Warner Bros.? A. Yes.

Q. Let me ask you whether in your observation and experience in the motion picture business, whether a producer who produces seven pictures which are [1348] financially successful, box office successes, out of eight pictures produced, whether that is a good average result for a producer?

Mr. Levy: I object to the question on the grounds it is incompetent, irrelevant and immaterial to the issues of the case, and particularly to the issues that are being tried before your Honor at this point.

Mr. Williams: We have a theory on the matter.

The Court: Is the purport of your question whether in that particular industry a producer who has seven financial successes out of eight attempts is considered successful or unsuccessful?

Mr. Williams: Yes.

The Court: Do you object to the question in that form?

Mr. Levy: No, your Honor, I don't.

Q. (By Mr. Williams): Will you answer the question?

The Court: I think the preceding question was objectionable, but you did not object to it. The preceding question called for the ultimate fact in issue here, whether the contract was beneficial to Warner Bros. Pictures, Inc.

Mr. Levy: He was referring to the last contract?

The Court: Yes.

Mr. Levy: This is the August 12 contract——

(Testimony of Samuel Schneider.)

The Court: I am not inviting you to assert it.

Mr. Levy: No, your Honor; I didn't object to it. I want to be very forthright and frank with your Honor that I felt I would take care of it on cross examination.

The Court: I did not imply any criticism. I interpret such a question as meaning, "Did you intend it to be beneficial to Warner Bros."?

Mr. Levy: That is what I really thought the question was directed to.

The Court: Very well.

The Witness: Shall I answer?

Mr. Williams: Yes.

The Witness: Based upon my experience in the motion picture business and based on the knowledge I have of pictures produced by other companies as well as our own companies, seven financial successes out of eight is very excellent.

Mr. Levy: Now, if Honor please, I move to strike the answer upon this ground: that it assumes a state of facts not in evidence.

The Court: What facts does it assume that are not in evidence?

Mr. Levy: It assumes the following facts not in evidence, namely, that the picture South of St. Louis was a success, that the picture Retreat, Hell, was a success, that the picture Distant Drums has been a financial success, [1350] whereas in the answer to the interrogatories it is indicated clearly and concisely that some of these pictures have not as yet recouped their cost, and there is no evidence

(Testimony of Samuel Schneider.)

now in this record which directly, indirectly, or my implication establishes the fact that seven out of eight pictures that have been produced by the defendant United States Pictures have been or are financial successes.

The Court: Of course, that is a matter of degree. It may be that at a certain stage in the process of recoupment, people who are experienced in the industry, in the business, would term the project a financial success, based upon past experience.

This witness has testified, as I understand his testimony, that he views the seven out of eight photoplays produced by United States Pictures under this arrangement to be financial successes. As he views them, would not the actual figures go to the weight of his testimony rather than to the competency?

Mr. Levy: Again I withdraw the objection.

The Court: You may answer.

The Witness: There was an answer.

Mr. Williams: There was a motion to strike.

Mr. Levy: Then I withdraw my motion to strike.

The Court: Very well.

The Witness: May I explain what I mean by financial [1351] success?

Q. (By Mr. Williams): Yes; please do.

A: Based upon the knowledge I have and the figures I studied before I left New York, seven of these pictures based on the terms of the contract will recoup, the negative cost will recoup all other

(Testimony of Samuel Schneider.)

costs of distribution charges, and will show a profit after that.

The Court: I take it that is based upon your experience with pictures in the past and based upon certain factors, such as how long it has been since they were first released?

The Witness: As a matter of fact, there are only two pictures, Distant Drums and Retreat, Hell, that have additional income to come in, and taking an approximate amount of the income that will come in, mostly from foreign countries, we are pretty sure about the ultimate result of those two pictures.

The Court: At the present stage in the process of exploitation, you consider that ultimately they will show a profit? That is upon what you base the characterization or measure of success?

The Witness: Yes; and there is very little left to recoup, to obtain that profit.

Q. (By Mr. Williams): Mr. Schneider, you have heretofore testified that you stated in conversation with Mr. [1352] Sperling that you did not think it advisable for United States Pictures to borrow money in the condition of the motion picture industry in 1947 to make additional pictures. What is the fact with reference to Warner Bros. itself as to whether it was to the business advantage or disadvantage of Warner Bros. to produce pictures or finance the production of pictures at that time?

Mr. Levy: I object to the question as improper in form and compound.

The Court: The objection is overruled. The ques-

(Testimony of Samuel Schneider.)

tion, as I understand it, calls for why the Warner Bros. Pictures, Inc., the corporation, was in any different position with respect to borrowing money than the United States Pictures was at that time.

Mr. Williams: Yes.

The Witness: First, I don't think I said I advised him not to borrow money. We discussed the conditions in the business, and we both talked about the fact that it might be inadvisable for United States Pictures to take the risk of borrowing money.

In answer to this question, Warner Bros. Pictures is a vast organization, with the exchanges throughout the world, with the hundreds of theatres that we own, and we were in constant need of product. We had to keep obtaining product to release and to justify our overhead. [1353]

In the case of Warner Bros. Pictures the advancement of money to produce pictures is our regular business, where, to a small independent unit, borrowing of money is quite a risk.

The Court: As you viewed it, then, I take it, the corporation had no choice, but United States Pictures did have a choice with respect to the risk of financing?

The Witness: Yes; our business was financing pictures, whereas with United States Pictures, I don't know whether they had a choice. They had a contract with us. We might have been able to force them to make the pictures, but due to certain circumstances and the falling receipts in our theatres, I, for one, felt that it would be more advantageous

(Testimony of Samuel Schneider.)

to our company to have United States Pictures continue to produce pictures even though we would put up most of the money, providing we could arrange the terms, which we did, and which I think are as favorable or more favorable to our company.

Q. (By Mr. Williams): It is a fact, is it not, that Warner Bros., if it was going to stay in business, had to continue to have pictures?

A. Yes.

Q. Whether they got them by making them themselves or having independent producers make them, they had to have pictures in order to supply their exchanges and theatres? [1354] A. Yes.

* * * * * [1355]

Cross Examination

* * * * * [1357]

Q. (By Mr. Levy): Do you remember when for the first time you discussed Exhibit 4 or the terms of Exhibit 4?

A. Prior to the signing of this contract.

Q. Prior to December 6, 1947? A. Yes.

* * * * *

Q. Do you know when it was signed?

A. No, I don't.

Q. It is dated December 6, 1947. We have had an instance in this case of the contract having been signed much later than it was dated, and therefore I ask do you know when this contract was signed, of your own knowledge? A. No, I don't.

* * * * *

(Testimony of Samuel Schneider.)

Q. Do you know where, what part of the country you were in on December 6, 1947 or about that time? A. No, I don't. * * * * * [1359]

Q. Now, Mr. Schneider, leaving that aside for the moment, do you know when My Girl Tisa was released first?

A. I think it was around March of 1948.

Q. You are referring to the first general release in the United States of the picture My Girl Tisa?

A. Yes. * * * * * [1363]

Q. And you know, do you not, that this picture was exhibited to the Army and to the Navy before it went into general release?

A. I don't know; but pictures are generally given to the Army and the Navy.

Q. No, no. I am talking about this picture.

The Court: What is "this picture"?

Mr. Levy: My Girl Tisa.

The Witness: I couldn't tell you positively about a picture from memory, but I do know that our pictures are given to the Army and Navy just prior to the release date. It might be, also, at the most, a few weeks.

Q. A few weeks before the release?

A. Yes. * * * * * [1365]

Q. Do you have anybody present for the purpose of getting an audience reaction to the picture when you release it to the Army and Navy?

A. Yes; the soldiers and sailors.

* * * * * [1366]

Q. Warner Bros. keeps a record, does it, of the

(Testimony of Samuel Schneider.)

dates when it receives the completed negative for distribution? A. Oh, yes.

Q. Where is that record located, to your knowledge?

A. I think in the studios here we would have a record as to when the picture was completed, and when it was started.

Q. No, no; I am not asking——

A. And when it was delivered.

Q. Ah, that is what I am talking about, when it was delivered to Warner Bros.

A. To our laboratory, yes. * * * * * [1369]

Q. That date is contained in a book somewhere?

A. Yes.

Q. In the studios?

A. They have the record. * * * * * [1373]

Mr. Williams: I have in my own record here the national release date was February 7, 1948.

The Court: The delivery from the producer to the distributor would antedate that?

Mr. Williams: Yes, it would antedate that. * * * * * [1374]

The Court: Perhaps you could tell us the importance of it. We are spending a great deal of time on it. * * * * *

The Court: You don't need to go into details. Is it for impeachment purposes, or does it affect some of the contemporaneous transactions, or does it have a bearing on subsequent transactions?

Mr. Levy: Yes; the plaintiff sees in this the

(Testimony of Samuel Schneider.)

probability that in this factual situation, namely, at the time Exhibit 4 was executed——

The Court: On what date?

Mr. Levy: It bears the date December 6, 1947. Warner Bros. and United States Pictures were aware, or had sufficient information to apprehend that My Girl Tisa was going to be a loser and not a winner, and that the additional-pictures contract was made facing that probability; and, if that is so, it would have a bearing [1376] on the bona fides of the parties with respect to the making of this additional-pictures contract, namely, Exhibit 4, and it would have an increased and it would have an additional and it would have a progressive bearing on the subsequent amendments to the contract.

The Court: This Exhibit 4 was subsequently ratified by the Board, was it not?

Mr. Levy: Yes, it was ratified by the Board some two and a half years later.

The Court: What about the minutes of United States Pictures? What do they show?

Mr. Levy: As to what?

The Court: The date of execution, or the date of authorization? * * * * * [1377]

Mr. Schwab: No, I do not believe that they were any board meetings being held with relation to the execution of any of the agreements with stars at the studio or anybody else.

Mr. Levy: We cannot have resort to the minute book of United States Pictures as a possible source of information as to when actually a contract which

(Testimony of Samuel Schneider.)

purports to be dated December 6, 1947 was in fact actually executed. * * * * * [1378]

The Court: While we are talking about it couldn't you, Mr. Williams, call up the studio, or some of these people here call up the studio——

Mr. Williams: I think we could.

The Court: ——and get the record down here while we are spending all this time?

Mr. Williams: I think we could, your Honor. I think we could ascertain that. * * * * *

Mr. Williams: Yes. Of course, my point is that it is utterly immaterial when the print is delivered to the laboratory.

The Court: One of the circumstances, relevant circumstances, [1379] under the plaintiff's theory. * * * * * [1380]

The Court: I want to be certain that I understand you. At the time Exhibit 7 was executed, it is your testimony that the corporation, Warner Bros., knew that a loss in a substantial sum, something like half a million dollars, would [1381] probably result from My Girl Tisa?

The Witness: Yes, on that picture by itself, not figuring any moneys that we might recoup from the profits of other pictures. Oh, yes. * * * * * [1382]

Q. (By Mr. Levy): So that you would say under those circumstances, having the figures in mind that you have just testified to, that on August 31st, 1948 Warner was in a position to apprehend, was it not, that the chances of the recovering of eight

(Testimony of Samuel Schneider.)

hundred and some odd thousand dollars that it advanced, or the production cost of My Girl Tisa, were very, very slim indeed, if any chance did exist? Would you say that?

A. Out of the picture My Girl Tisa we were——

Q. That is what I am referring to.

A. ——we were positive that we would not recoup the cost of the picture, even on August 31, 1948.

Q. Right. For the reason, among other things, that the bank got the first money, did it not?

A. Yes; and also because we knew of the business that the picture was doing. [1388]

* * * * *

Q. Mr. Schneider, on August 17, 1950, when Exhibit 7 in evidence, which is the second amendmend to the basic contract involving the additional pictures, was approved, were you aware of the fact that the effect thereof would be to postpone the obligation upon the part of United States Pictures to pay to Warner Bros. any deficiency resulting from the loss on My Girl Tisa to approximately January of 1947?

A. I was aware that there would be a postponement of the obligation to pay from the release date of the last of the six pictures, whenever released, four years after that, whatever the date would be.

Q. That would bring it down, according to my calculation, to approximately January, 1957.

A. If the last of the six pictures was released four years prior to that.

(Testimony of Samuel Schneider.)

Q. That is right. A. Yes.

Q. You participated, did you not—and if you did not, please say so—in the postponement that was granted to United States Pictures by the terms of the August 12, 1952, contract? It is in evidence here as Schedule H attached to Exhibit 107.

A. Yes.

Q. You were aware then, were you not, that the [1400] postponement that we spoke about previously would have the effect of postponing the United States Pictures' obligation as a fixed obligation to pay Warner Bros. any deficiency resulting from the loss on My Girl Tisa to approximately January, 1959?

A. The same answer prevails.

Q. Yes.

A. That there would be a postponement.

Q. Yes.

A. Whatever the deficiency might be.

Q. I ask you this question: Were you aware of the fact that by the terms of paragraph 5 of Exhibit 4 in evidence, namely, the December 6, 1947, amendment, the agreement between United States Pictures and Warner Bros. was to the following effect: Warner Bros. said to United States Pictures:

"You agree that prior to the commencement of the principal photography of any of the photoplays hereinbefore referred to and about to be produced

(Testimony of Samuel Schneider.)

same shall be a remaining photoplay or an additional photoplay as hereinbefore referred to"?

You were aware of that clause in that contract?

A. Yes.

Q. Did that clause mean anything to you from the [1401] point of view of Warner Bros.?

A. Yes.

Q. Were you aware of the fact that under and by virtue of the provisions of that clause, United States Pictures could call upon Warner Bros. to advance 100 per cent of the cost of preparation of any picture that it was engaged in producing—and when I say preparation, I mean from the acquisition of the story, its treatment, its conversion into a screen play, any expense involved in the pre-production of any picture—Warner Bros. would have to advance 100 per cent of all of the cost of that up to the point at which United would walk onto the sound stages and begin turning the cameras? Were you aware that was the situation?

A. It actually doesn't work that way, that they wait until they are on the stage to turn the cameras, but in substance I was aware of the fact that Warner Bros. Pictures could be called upon to advance whatever money was necessary to obtain a story, prepare the story and write a screen play, pre-production expenses, up to the point they would designate whether the picture would be an original or additional picture.

The Court: Whether what?

The Witness: Whether at the time United States

(Testimony of Samuel Schneider.)

Pictures would advise us as to whether or not they choose [1402] to go to the bank and borrow half the money and produce the picture under the terms of the original agreement. I was aware of that.

Q. (By Mr. Levy): Did you consider that of considerable advantage to United States Pictures?

A. No.

Q. You did not?

A. No. I did not consider it of any advantage to the United States Pictures, the fact that they could wait a certain time before they decided under which basis they want to produce the picture.

Q. You did not think it was to the advantage of United States Pictures to have Warner foot the bills in order to get the package, so to speak, in shape before they begin turning the cameras?

A. I don't think that was an advantage.

Q. How long have you been in the motion picture business, Mr. Schneider?

A. 30 years with Warner Bros.

Q. You have spoken to a good many independent producers during your time? A. Many.

Q. You know, do you not, that it is one of the important factors that enter into independent production of a motion picture to have the money that is involved in the [1403] pre-production of the picture, do you? A. Yes.

Q. That is an important element in independent motion picture production, isn't it? A. Yes.

Q. If you haven't got the money with which to prepare a picture up to the point at which you

(Testimony of Samuel Schneider.)

begin turning the cameras on it, you might as well not be in the business; isn't that so?

A. I can't imagine how you could prepare a picture without having any money. [1404]

* * * * *

Q. Who suggested that paragraph be inserted in the contract? Did you?

A. What paragraph is this?

Q. Paragraph 5 that I just read to you.

The Court: Paragraph 5 of what exhibit?

Mr. Levy: Paragraph 5 of Exhibit 4.

The Witness: No, I didn't suggest that paragraph.

Q. Do you know who did suggest it?

A. No, I don't. [1407]

* * * * *

Q. Did you see any advantage to Warner Bros. in giving United States Pictures the option of declaring a picture to be an original picture instead of an additional picture? A. No.

* * * * *

Q. You didn't? I call your attention to paragraph 10 of the agreement.

Mr. Williams: Still referring to Exhibit 4?

Mr. Levy: Still referring to Exhibit 4. [1408]

* * * * *

Q. (By Mr. Levy): Are you aware of the fact that United States Pictures was receiving a decided advantage under the terms of that paragraph? A. No.

Q. Sir?

(Testimony of Samuel Schneider.)

A. No, I wasn't aware that they were receiving a decided advantage.

As I explained before, the whole spirit of the deal was that it was a joint venture, so that whatever we could make available or finance for United States Pictures to enable them to make motion pictures suitable for distribution would be advantageous to Warner Bros. Pictures. [1409]

* * * * *

Q. Were you aware of the fact that under the basic agreement, under the basic contract, United States Pictures had the right to make outside photoplays, that is [1412] to say, outside pictures, pictures in which Warner Bros. would have no interest, financial or otherwise?

A. I knew that the contract provided that.

* * * * * [1413]

Q. Did you ever receive a final and fully itemized statement of the production cost of the picture Cloak and Dagger? A. Yes.

Q. Did you observe on that final and fully itemized statement that United States Pictures had allocated approximately $116,000, let us say over $100,000, as United States Pictures' overhead with respect to that picture?

A. I don't recall the amount, but I did see a final statement, if that is the amount,——

* * * * *

A. ——if that is the amount of that statement, then that is what I saw. [1419]

* * * * *

(Testimony of Samuel Schneider.)

Q. Did the thought occur to you that the figure $116,000 was rather high?

A. Well, now, let me think a moment. I think the picture cost about $1,800,000, if I recollect. So that the direct cost of that picture would be about $1,300,000, a million three hundred to a million four hundred thousand. [1420] So that $116,000 would be abou less than 10 per cent.

Q. You thought that was reasonable, didn't you?

A. Well, it is not a question of whether I thought it was reasonable. I knew that in order to run United States Pictures they would have certain expenses.

* * * * *

Q. Expenses sufficient to involve them in a cost of $116,000 as against one picture as overhead?

A. Well, of course, if he would have produced two pictures in that time that he produced one picture, the overhead would have been 50 per cent of that amount on each picture. As it happened, whatever the circumstances were, he made this one picture, and it is just as difficult to make one picture costing $1,800,000 as it is to make two pictures costing $800,000 apiece. There is a lot of things and there is a lot of longer production schedule.

Q. We are talking of overhead, Mr. Schneider.

A. Yes. I say it took United States Pictures a longer time to make this one picture, so that there was a larger amount of overhead charged to a picture, just the same as Warner Bros. Pictures charged a greater amount of overhead to that pic-

(Testimony of Samuel Schneider.)

ture than they would have charged if the picture cost half as much.

Q. Did you at any time know, Mr. Schneider, that United [1421] States Pictures produced two pictures in the year 1946; No. 1, Cloak and Dagger, to which it allocated as overhead $116,000; and Pursued, to which it allocated in that same year $129,000 as overhead? The total of those two figures that I gave you is obviously $245,000. Did you ever pause to think that United States Pictures had reported to Warner Bros. and that report came across your desk, that for the year 1946 United States Pictures had an overhead of approximately a quarter of a million dollars, or, let us say, $230,000-odd.

A. I don't think the overhead for one year was that much. I don't think they produced two pictures in one year, from my recollection.

Q. Don't you?

A. No. I think it took longer than that, just my memory. I would have to actually look at the record.

Q. If I were to tell you that they had, would that mean anything to you?

A. Well, just let me think a moment. I would imagine that Cloak and Dagger and Pursued took more than a year to produce and absorbed more than one year of the United States overhead, from my recollection.

Q. Mr. Schneider, what do you mean by "absorbed"? What do you mean by your last answer "absorbed more than one year's overhead"? [1422]

(Testimony of Samuel Schneider.)

A. In other words, I think that the two pictures, the amount of overhead that United States Pictures charged to those pictures was more than one year of its overhead. I don't think their overhead amounted to that much in one year, just my own——

Q. If they said that that was the overhead for 1946, if United States Pictures stated in writing and that writing came across your desk, namely, United States Pictures' overhead for the year 1946 is $235,000, would that have caused you any concern as representing the Warner Bros. office?

Mr. Williams: Just a moment. That is purely speculation, if your Honor please, and objected to on that ground.

The Court: Overruled. He may answer.

A. If I was advised at that time that the United States Pictures' overhead for the entire year of 1946 was $230,000-some odd, as you stated, I would think it was high, but would also imagine that there are many charges and expenditures in that year which might apply to subsequent productions, such as may be the purchase of scripts or stories.

Q. (By Mr. Levy): Did you at any time prior to December 6, 1947, did you at any time prior to that time know that United States Pictures had included in its overhead for the year 1946 over $50,000 representing the cost of literary properties that United States Pictures had purchased up to

(Testimony of Samuel Schneider.)

[1423] the end of the year 1946, had not used, but had abandoned them? Did you know that?

A. No. I didn't know that exact fact, although I knew that they were buying literary properties and I wouldn't—during 1947 I wouldn't imagine that they abandoned all the properties that they had purchased, even though they might have written them off.

Q. So you did not know then, Mr. Schneider, that United States Pictures actually abandoned stories during 1946, wrote them off, and included in the overhead for the year 1946 the 50-odd thousand dollars which represented those write-offs? You did not know that?

A. How do you get the knowledge that they abandoned them?

Mr. Levy: They admit it.

Mr. Williams: Now, just a moment, if your Honor pleases. I object to that statement. The witness answered, based on a question, your Honor. I object as not——

The Witness: Warner Bros.——

The Court: Is the fact not in evidence?

Mr. Williams: Not that fact.

The Witness: When Warner—can I state?

The Court: The question is improper if it is not based on facts in evidence.

Mr. Levy: If it is not based on facts in evidence, your [1424] Honor, I shall withdraw the question and I shall apologize humbly.

The Witness: Might I finish my answer there?

(Testimony of Samuel Schneider.)

The Court: Does the defense contend that it is predicated upon facts not in evidence?

Mr. Williams: Yes, if your Honor please.

The Court: What facts?

Mr. Williams: The fact that there was a $50,000 writeoff in the year 1946 for abandoned stories.

The Court: Mr. Levy, this can go on endlessly. The executives of Warner Bros. are charged with knowledge of whatever the facts were. And what purpose does it serve to go over it with this witness?

Mr. Levy: May I state the purpose?

The Court: Is it to give him a memory test on it?

Mr. Levy: My purpose——

The Court: If you want to ask him hypothetically if he had known the facts were such and such, would he have acted differently, I think that might get us somewhere. But just merely to ask him, time after time, if he knows these things is just a memory test, as I view it.

Mr. Levy: May I state my purpose, your Honor? I really have a purpose, and the purpose is this: To show that this witness was controlled by Harry Warner, to show that he was a "yes" man for Harry Warner. [1425]

The Court: How does conducting a memory test show whether he was? All these things are purely relative. You can say in a treble tone "There is $250,000," but that may be nothing. It may be exorbitant, it may be outrageous, but it is all rela-

(Testimony of Samuel Schneider.)

tive. Unless it is related to something else, standing alone it means nothing to me.

Mr. Levy: Very well, your Honor.

Q. Mr. Schneider, may I ask you this question: Do you know of any other producer with whom Warner has made an independent motion picture production-distribution agreement who allocated as much as $204,000 as overhead to a particular picture?

A. I don't think we had a contract of this kind with any other producer.

Q. I asked you this question: Do you know of any case in which Warner Bros. entered into a contract with any independent producer in which the independent producer was permitted to charge, to allocate to a picture as much as $204,000 as overhead?

Mr. Williams: Now, just a moment, if your Honor please. That assumes that there were other contracts under which independent producers allocated overhead. Counsel well knows, and he has examined the contracts, the other contracts do not provide any such thing, and consequently that question means nothing. [1426]

The Court: Do you mean a single picture?

Mr. Levy: A single picture.

The Court: Overruled. You may answer. Do you know?

A. We have no other contract with a producer, with an independent producer of this type which permits what you just asked.

(Testimony of Samuel Schneider.)

The Court: The answer is "no"?

The Witness: No. [1427]

* * * * *

Mr. Williams: May Mr. Schneider be excused from further attendance?

The Court: Is there any occasion to require him to remain here?

Mr. Levy: I am just wondering, your Honor. The reason why I say there might be some occasion is this: We are trying, as I understood, limited issues here now, and this applies to both this witness and the witness Mr. Friedman who preceded him. They are New York people and [1429] I readily realize that they want to get back as quickly as possible. But we are trying limited issues here.

The Court: Mr. Levy, you may need them tomorrow. We will ask them to remain until tomorrow. I hope that we can reach a conclusion of the evidence tomorrow on this matter.

Mr. Levy: On the issues that we are trying now, your Honor?

The Court: On the two issues, yes; on the issue as to jurisdiction and as to laches or limitation.

* * * * * [1430]

DEPOSITION OF MILTON SPERLING

a defendant in the above-entitled action, taken on behalf of the plaintiff, at 1:30 o'clock p.m. on Wednesday, November 22, 1950, at 4000 West Olive Avenue, Burbank, California, before William H. Burgess, Jr., a Notary Public within and for the County of Los Angeles and State of California, pursuant to the annexed stipulation. [1440]

* * * * *

By Mr. Lyon:

Q. Do you know of any expenses that United States Pictures has which it does not put in as an overhead [1478] expense and charge to pictures produced, to date?

A. All so-called direct costs appear on the budgets as direct costs.

Q. I mean other than direct costs.

A. I do not know of any. [1479]

* * * * *

HERBERT FRESTON—(Recalled)

Cross Examination

* * * * *

Mr. Levy: At this time, your Honor, I offer Exhibits G, H and I that are marked for identification into evidence.

The Court: Is there objection?

Mr. Williams: No, your Honor. [1487]

The Court: Received in evidence.

(Testimony of Herbert Freston.)

(The document was thereupon marked Defendants' Exhibits G, H, and I, and received in evidence.)

* * * * *

Q. (By Mr. Levy): Mr. Freston, I referred to the letter that is contained—the letter that you referred to on page 24 of the Exhibit J from which you copied an excerpt. Have you it before you?

A. I will get it.

* * * * *

The Court: Has that letter been marked?

Mr. Levy: No, your Honor. It is just referred to in Exhibit J.

The Witness: I will see if I can find it.

Mr. Levy: Do you think somebody else could find it [1488] just as readily and we could go on?

* * * * *

The Witness: I hand you the letter dated November 6, 1945, attached to which is an amendment of paragraph Thirty-first of basic agreement Exhibit 1, together with a printed copy of the loan agreement between Warner Bros. Pictures, Inc. and the syndicate of New York banks.

* * * * *

The Court: Very well, it will be marked Exhibit J-1 for identification. [1489]

* * * * *

The Court: Received in evidence.

* * * * *

Q. (By Mr. Levy): Mr. Freston, in the course of your representation of the defendant Warner

(Testimony of Herbert Freston.)

Bros., Inc., did you have occasion to render professional services to either Harry or Jack Warner as individuals?

A. From time to time through the years for both of them.

The Court: By that do you mean was he the attorney for the individuals?

Mr. Levy: Yes, your Honor.

The Court: Did you so understand it?

The Witness: I handled matters for them once in a while, your Honor. I think they had other attorneys from time to time, also. It was not an exclusive relationship.

Q. (By Mr. Levy): I understand, but you did act as attorney for Harry Warner and Jack Warner from time to time as individuals?

A. That is correct. [1490]

* * * * *

MORTON BARNARD BLUMENSTOCK

called as a witness on behalf of defendant, having been first duly sworn, testified as follows:

* * * * *

Direct Examination

Q. (By Mr. Williams): Mr. Blumenstock, are you connected with Warner Bros. Pictures, Inc.?

A. Yes, sir.

Q. In what capacity?

A. As vice president.

Q. Do you have charge of a department?

A. I do.

(Testimony of Morton Barnard Blumenstock.)

Q. What department?

A. Advertising and publicity. [1494]

Q. How long have you been in charge of that department, or those departments?

A. About 15 years.

Q. Prior to that did you work in advertising and publicity for Warner Bros.? A. I did.

Q. How many years all together have you been connected with Warner Bros.?

A. About 28.

Q. In 1945 where was your office?

A. New York.

Q. At that time you had charge of advertising and publicity for Warner Bros.?

A. That is right.

Q. Are you familiar with the fact that about the 28th of September, 1945, an agreement was made between United States Pictures and Warner Bros. for the production by United States Pictures and the distribution by Warner Bros. of certain motion pictures?

A. I was familiar at that time with such a deal.

Q. Did you at that time arrange for publicity to be given to that matter?

A. I did.

Q. Did any person or persons request or suggest that you arrange for such publicity? [1495]

A. I believe Mr. Warner acquainted me with the details of the arrangement which he wanted to announce, our publicity and advertising.

Q. Which Mr. Warner?

(Testimony of Morton Barnard Blumenstock.)

A. Mr. J. L. Warner.

Q. Did you at that time arrange for the placing of advertising in a certain number of trade journals? A. Yes.

Mr. Williams: I would ask the clerk to place before the witness Exhibits D and E for identification.

Q. I ask you, Mr. Blumenstock, to refer first to Exhibit D for identification, and particularly to the back part of that, and I ask you whether you recognize the advertising which appears on the back of that exhibit as advertising which was placed under your direction in the Daily Variety.

A. That is correct.

Q. I will ask you to examine Exhibit E for identification and state whether you recognize the advertisement which appears upon the back of that exhibit as an advertisement which you caused to be placed in the Hollywood Reporter.

A. Yes; they are identical and they appeared in both papers.

Q. Did you have identical ads put in other papers? [1496] A. Yes.

Q. Did those appear on or about the dates that the ads appeared in the Daily Variety, Exhibit D, and the Hollywood Reporter, Exhibit E, both for identification?

A. On or about. I believe they were subsequent to the appearance——

Q. Do you remember their having been in a number of other papers?

(Testimony of Morton Barnard Blumenstock.)

A. I remember that they were, more accurately. I had my office give me a schedule of appearances at that time.

Q. Will you state in what other publications this same ad appeared, and the dates when it appeared?

A. These advertisements appeared, the identical advertisement appeared in Film Daily, a New York publication, on October 2nd.

Mr. Levy: Just a moment. I move to strike the answer of the witness on the ground it is not the best evidence, in the first place.

I rest on the objection on that ground.

Mr. Williams: We think it is proper, if your Honor please, in view of the fact that the format and character of the ad has been shown, and that this witness knows that it was placed in the paper.

The Court: Does it appear in this record that the [1497] witness subsequently saw these publications?

Mr. Williams: I will ask that question.

Q. Did you see the publications, the ad as it appeared in the various papers in which it was then placed?

A. You mean at the time of the publication?

Q. Yes. A. That is part of my job.

Q. You did see them?

A. I would have to.

Q. You did? A. Yes.

Q. All right.

(Testimony of Morton Barnard Blumenstock.)

The Court: The motion is denied. The objection is overruled.

Mr. Reporter, was there an answer to the question to which Mr. Levy made an objection?

(The record was read, as follows:

"Q. Will you state in what other publications this same ad appeared and the dates when it appeared?

"A. These advertisements appeared, the identical advertisement appeared in Film Daily, a New York publication, on October 2nd.")

Mr. Levy: And it was that answer that I made a motion to strike.

Q. (By Mr. Williams): What year; 1945?

A. 1945.

Mr. Levy: And now I move to strike the answer again, if your Honor please, on the grounds that the testimony is incompetent, irrelevant, and immaterial, and has no bearing on the issues that are now being tried.

The Court: Do you expect to offer Exhibits D and E in evidence?

Mr. Williams: I will at this time offer Exhibits D and E in evidence, if your Honor please.

The Court: Is there any objection?

Mr. Levy: No objection to these exhibits.

The Court: Exhibits D and E for identification are now received in evidence. May I see them, Mr. Clerk?

(Defendants' Exhibits D and E for identification were thereupon received in evidence.)

(Testimony of Morton Barnard Blumenstock.)

The Court: You are not addressing your objection to the offer of these exhibits?

Mr. Levy: Not these two, no.

The Court: You are addressing your objection to the pending question?

Mr. Levy: I am referring to the pending question, that is, the question directed to the witness about advertisements made in other publications which are not here present.

The Court: I believe the present state of the record [1499] is that the answers were given and you made a motion to strike on that ground?

Mr. Levy: Yes; I make a motion to strike the answer.

The Court: The motion is denied. The objection is overruled.

* * * * *

A. The other publications in which this advertisement appeared were Weekly Variety, October 3rd issue, 1945. That is a New York publication. Motion Picture Daily, another publication, the same advertisement appeared October [1500] 4, 1945. Box Office, a Kansas City publication, the same advertisement appeared October 6, 1945. Exhibitor, a Philadelphia publication, the same advertisement appeared October 10, 1945. Motion Picture Herald, a weekly New York publication, the same advertisement appeared October 13, 1945. Showman's Trade Review, an eastern publication published in New York City, the same advertisement appeared October 13, 1945.

(Testimony of Morton Barnard Blumenstock.)

Q. The Daily Variety and the Hollywood Reporter, which have been received in evidence as Exhibits D and E, are both California publications?

A. Los Angeles publications, yes. [1501]

* * * * *

SAMUEL SCHNEIDER

recalled to the stand on behalf of defendants, previously sworn, testified further as follows:

Cross Examination—(Resumed)

Q. (By Mr. Levy): Mr. Schneider, I omitted to ask you, prior to December 6, 1947, the date of Exhibit 4 in evidence, were you aware of the fact that Mr. Harry Warner had personally guaranteed an obligation from United States Pictures to the New York Trust Company in the sum of $150,000, evidenced by a demand note in that sum, dated March 3, 1947? A. Yes.

Q. You were, of course, aware of that fact, were you not, on August 17, 1950, and you were also aware of that fact on August 12, 1952?

A. Yes.

Q. On or about the dates that I have called your attention to, were you aware of the fact that 62 shares of the capital stock of United States Pictures was held in [1585] trust by the Title Insurance and Trust Company of Los Angeles for the benefit of Mr. Sperling's minor children?

A. I cannot say that I was aware of that fact on those dates.

(Testimony of Samuel Schneider.)

Q. Did you before December 6, 1947, know that 62 shares, or some shares of United States Pictures were being held in trust by the company whose name I have just mentioned, for the benefit of Mr. Sperling's minor children?

A. I was not too familiar with that at any time, and I cannot say that I did not know it, because in conversations with Milton Sperling he mentioned something about that, which was not too significant to me.

Q. Were you aware of the fact that Mr. Bernhard severed his relationship with United States Pictures on or about September 18, 1946?

A. Yes.

Q. Were you also aware of the fact that when he so severed his relationship with United States Pictures he sold his interest in United States Pictures, his stock interest, namely, 125 shares of the capital stock of United States Pictures, to Milton Sperling for the sum of $400,000 in cash?

A. Yes.

Q. Were you also aware of the fact that in order to pay Mr. Bernhard the purchase price of those shares of [1586] stock, Mr. Sperling had borrowed that sum, namely, $400,000, from the New York Trust Company?

A. I knew that he was arranging for a loan at the New York Trust Company.

Q. Were you aware of the fact that in order to obtain that loan it became necessary for Mrs. Betty Sperling to pledge collateral owned by her, namely,

(Testimony of Samuel Schneider.)

a share in Warner Pictures Corporation stock, to the New York Trust Company?

A. I was generally familiar with those facts.

* * * * * [1587]

The Court: Do both sides rest on the issues as to jurisdiction, laches, or limitation?

Mr. Williams: Yes, your Honor.

Mr. Levy: Yes, your Honor. * * * * * [1625]

The Court: If we take up the case further on the merits, it would be sometime in July, the last half of July, or in the fall. * * * * * [1629]

JOSEPH CHARLES YOSS

recalled as a witness on behalf of defendants, previously sworn, testified further as follows:

* * * * *

Cross Examination

Q. (By Mr. Levy): Mr. Yoss, you are a vice president of the defendant United States Pictures?

A. Yes.

Q. You are the accountant for United States Pictures? A. Yes. * * * * *[1775]

Recross Examination

The Court: What are you seeking to show?

Mr. Levy: I am seeking to show how much United States Pictures was entitled to receive according to the defendants' theory from all of these additional pictures which they say they have retained to diminish the loss.

The Court: Why don't you ask this witness for

(Testimony of Joseph Charles Yoss.)

the figures, and the conclusion to be placed on the figures is another matter? If you want to ask him what 20 per cent of the net profit was, you may, or however you may wish to [1794] phrase it.

Mr. Levy: Yes, your Honor.

Q. What is the 20 per cent of the net profit on the picture South of St. Louis up to November 29, 1952, Mr. Yoss?

A. Mr. Levy, I don't know what net profits on this picture, or whose net profits on this picture you are referring to.

Q. United States Pictures, Mr. Yoss.

A. Then I must tell you that we have had no net profits yet on this picture.

The Court: Mr. Yoss, do you know what he is asking you? He is asking you what figures represent 20 per cent, whether you have ever received it or not. Don't be captious about it.

The Witness: The answer is $30,498.18.

Q. (By Mr. Levy): What about Three Secrets, how much?

The Court: Are there several of these you are going into?

Mr. Levy: I think there is one more on which there has been a profit.

The Witness: Calculated on the same basis as the prior answer, except as to date, that would be to November 29, 1952, the answer would be $34,682.97.

Q. Can you do the same with The Enforcer?

A. The answer on The Enforcer to November

(Testimony of Joseph Charles Yoss.)

29, 1952 [1795] on the same basis, would be $32,451.18.

Q. Is there any other picture beyond The Enforcer of the balance that are in the same class, namely, that have resulted in an excess of gross receipts over the total cost of production and distribution? A. No.

Q. These are the only three pictures, is that correct, in which there has been an excess of gross receipts over and above the grand total of production, distribution allowance, and expenses?

A. Produced subsequent to Tisa, of course, excluding Cloak and Dagger and Pursued.

Q. Yes, excluding those. I am talking of additional pictures.

A. That is right.

Q. The pictures that followed The Enforcer were which? A. Distant Drums and Retreat, Hell.

Q. Distant Drums and Retreat, Hell?

A. Distant Drums and Retreat, Hell.

Q. These two pictures have not yet recouped their cost?

Mr. Williams: We are talking as of what date?

Mr. Levy: November 29, 1952.

The Witness: There is a small balance as of November [1796] 29, 1952.

Q. In whose favor?

A. Of costs yet to recoup.

Q. Of costs yet to recoup? A. Yes.

Q. The total of the figures that you have just calculated is what? A. $97,632.33.

Mr. Levy: I have no further questions. I have no objection to the introduction of this exhibit in evidence. * * * * *

The Court: Is there any further evidence to be offered on the issues as to jurisdiction, limitation, or laches?

Mr. Levy: May it please the court, I have been thinking over very carefully some of the questions your Honor propounded to me yesterday in our discussion with respect to the meaning of hostility, antagonism, etc., etc. I was wondering whether a cross examination of the [1797] principal characters in this drama would shed any light on that particular subject.

In the present state of the record, your Honor has before you the depositions of Harry Warner, Jack Warner, Milton Sperling, and Joseph Bernhard, these being the gentlemen who originally entered into these arrangements, planned this from the very start, and participated in the bringing into being all of the transactions that are at issue in this case.

I have not cross examined any one of these people. It may be that a cross examination of them will yield further light on the question, namely, is there hostility, is there antagonism between the corporation as composed of the individuals who influence its day-to-day conduct and are responsible for its basic policy, are responsible for not only its executive decisions in the making of contracts, but are responsible for the attitude that the corporation

will take when questioned by a stockholder, or when challenged by a stockholder that their behavior was or was not according to the stockholder's conception of what was right under the circumstances.

The Court: I should assume, unless there is some contention expressly made to the contrary, that this corporation would never have brought this suit. Is there any contention to the contrary?

Mr. Levy: That what, your Honor?

Mr. Williams: We don't make such contention.

The Court: That if the stockholder had made demand on the directors and waited any period of time, the suit would never have been brought by the corporation.

Mr. Williams: No, certainly not.

The Court: So far as demand and refusal are concerned, I take it, the defendant, in effect, stipulates that a demand would have been futile.

Mr. Williams: But not for the reasons alleged in the complaint.

The Court: No; but for the reasons contended by the defendant.

Mr. Williams: Certainly not for the reason that the defendants ever contended the contract was fraudulent.

Mr. Levy: I have no further evidence to offer, under those circumstances.

The Court: As I understand the defendants' position, and I can be corrected if I am in error, the defendants' position is that this was an advantageous arrangement to the Warner corporation, and the directors would have upheld it at any time

against any attack by any person, including any group of stockholders.

Mr. Levy: That is the position of both the individual defendants Warner brothers and the corporation— [1799] all of them contend likewise.

Mr. Williams: The individual defendants Warner brothers are not involved in that issue. It is the corporation that is involved in that issue.

The Court: And, for those reasons, no matter what demand the plaintiff stockholder had made on the directors, they would never have brought this suit. Is that a fair statement of it?

Mr. Williams: Yes, that is a fair statement, but not for the reasons alleged in the complaint, that there was domination; but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract.

The Court: By "good", you mean advantageous to the corporation?

Mr. Williams: Advantageous to the Warner corporation, yes.

The Court: If you have closed the evidence, we will proceed with the arguments at two o'clock.

* * * * * [1800]

Mr. Williams: I move for a judgment of dismissal in favor of the defendants in this case, first on the ground that the court has no jurisdiction of the action, and, second, a judgment in favor of the defendants on the ground that the action was brought more than three years after the acts complained of, and is barred by the provisions of the statute of limitations of the State of California a[illegible]

the statute of limitations of the State of Delaware, each of them being substantially a three-year statute. I simply make those motions formally at this time in preparation for the argument.

The Court: I construe those motions, unless there is objection, to be motions for all of the defendants.

Mr. Williams: All of the defendants, yes.

The Court: First, to dismiss the action for want of jurisdiction over the subject matter, because of laches and diversity of citizenship?

Mr. Williams: Yes, your Honor.

The Court: And, secondly, to dismiss the action on the ground that the charges brought are barred by limitations or laches, as the case may be, or by both limitations and laches, which would be the proper motion, I take it.

Mr. Williams: Yes. * * * * * [1801]

Mr. Levy: May it please the court, your Honor will recall, and Mr. Williams, that I requested the record of the film negative, completed negative, of My Girl Tisa from United States Pictures to Warner Bros. Pictures. You asked Mr. Williams whether that date could not be gotten over the telephone prior to the bringing of the record into this court. We had forgotten all about that. I spoke to Mr. Williams about it this morning and asked him to please produce that record so that it can be made part of the evidence in this case.

The Court: Could someone get that this morning?

Mr. Williams: I can get it today. The record is in [1909] New York, and it is a negative which

was mailed in New York to the laboratory. The laboratory records show the date it was received, November 21, 1947. That I got by telephone, but there was never anything said to me about getting any record.

The Court: No, just the date, as I understood it, without the necessity of bringing the record.

* * * * * [1910]

Mr. Kelly: Now, your Honor, equity is not a one-way street. Usually we have a complainant of this kind asserting acts of fraud. Unfortunately in these suits we have a corporation that is subject to tremendous expense that they can be put to in defending a suit of this kind.

We beg the court, as a court of equity, to consider the equities of the defendants, both the individual directors and the company. We have a perfect example here of——

The Court: The company is not defending the suit, in a sense, is it?

Mr. Kelly: Sir?

The Court: Is the corporation here defending?

Mr. Kelly: It is aligned as the defendant, your Honor. I am pointing out to the court that presumably under the cloak of equity this plaintiff is seeking to do something for the corporation.

* * * * * [1973]

[Endorsed]: Filed April 26, 1954.

[Endorsed]: No. 14334. United States Court of Appeals for the Ninth Circuit. Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, deceased, Appellant, vs. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Appellees. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: April 28, 1954.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14334

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,
Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC.,
Appellees.

STATEMENT OF POINTS ON APPEAL AND ASSIGNMENT OF ERRORS

The following are Appellants' points in seeking a reversal of the judgment dismissing the suit upon

the ground that the Court had no jurisdiction of the subject-matter. (Respondent Warner Bros. Picture Corporation is hereinafter referred to as "Warner" and respondent United States Pictures, Inc. is hereinafter referred to as "United".)

I.

It was error for the District Court to align Respondent Warner alongside Appellant because these parties are admittedly on opposite sides of a controversy in which the real matter in dispute is: Whether Warner has been dealt with unlawfully and unfairly, in a joint venture in motion picture production-distribution that was admittedly organized by Respondents Warner and United in 1945 and has been conducted by them ever since.

II.

Facts which are not in dispute disclose the presence of a justiciable controversy between Appellant and Respondent Warner, as a matter of law.

III.

The record discloses certain material facts, each of which is not in dispute and properly the subject of a finding. The learned District Court erroneously omitted to find these facts to be true and to include them in its findings. Considered in the light of these omitted facts, the District Court's findings are rendered insufficient to support the conclusion, to wit: That for jurisdictional purposes, Respond-

ent Warner should be realigned and placed along side the Plaintiff Stockholder.

IV.

The contract between Warner and United (referred to in the findings as "The Contract in Controversy") is illegal. Equally illegal is the series of amendments and supplements thereto which were—admittedly—executed and acted upon by the Corporate Respondents.

V.

The seventy-eight thousand ($78,000.00) dollar payment by Warner to Joseph Bernhard is illegal.

VI.

Facts which are not in dispute establish as a matter of law that Warner was in hands antagonistic to its financial interests and those of its stockholders. The District Court erred in finding or concluding, to wit:

> "nor, was said corporation at any time herein referred to in hands or under control antagonistic to the financial interests of said corporation and its stockholders."

VII.

Directors' admissions exhibit and establish Harry Warner as controlling the composition of the Warner directorate and dominating its membership, as a matter of law. In view of said admissions, the District Court erred in concluding that "Neither the corporation nor its directors or officers were shown

to be at that time or at any time under the domination and control of the three Warner Brothers."

VIII.

The findings are insufficient as a matter of law, to sustain the conclusion with respect to the first cause of action, to wit: "That Warner Bros. Pictures, Inc. should be realigned as a party plaintiff."

IX.

The conclusion of law with respect to the second cause of action numbered 1, to wit:—"And therefore the Court finds that United States Pictures, Inc., is a party so necessary and indispensable that a court of equity will not proceed to determination without it; and that without said corporation as a party, the cause of action is without equity." is contrary to law.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY

Affidavit of Service by Mail attached.

[Endorsed]: Filed June 16, 1954. Paul P. O'Brien, Clerk.

At a Stated Term, to wit: The October Term A.D. 1953, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City of Los Angeles, in the State of California, on Monday, the second day of August, in the year of our Lord one thousand nine hundred and fifty-four.

Present: Honorable Albert Lee Stephens, Circuit Judge, Presiding; Honorable James Alger Fee, Circuit Judge; Honorable Chase A. Clark, Circuit Judge.

[Title of Cause.]

ORDER SUBMITTING MOTION RE RECORD ON APPEAL AND GRANTING MOTION IN PART

Ordered motion of appellant to permit appeal to be prosecuted on original exhibits, etc., submitted to the court for consideration and decision on papers filed, pursuant to oral stipulation of Mr. Herman H. Levy, counsel for appellant, and by Mr. Eugene B. Williams, counsel for appellees.

On consideration thereof, It Is Further Ordered that leave be, and hereby is granted to appellant to prosecute the appeal herein on original exhibits, and that reference to the District Court's opinion in the Federal Supplement be permitted instead of reproducing said opinion in the printed transcript, but that the portion of the motion for hearing of cause on typewritten transcript of the evidence be, and hereby is denied.

[fol. 597] IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

PLAINTIFF'S EXHIBIT 21

Warner Bros. Pictures, Inc.

Notice of Annual Meeting of Stockholders

New York, N. Y., January 10, 1946.

To the Stockholders of Warner Bros. Pictures, Inc.

Notice Is Hereby Given that the Annual Meeting of Stockholders of Warner Bros. Pictures, Inc. will be held at the principal office of the Corporation at 100 West 10th Street, Wilmington, Delaware, on Tuesday, February 19, 1946, at 11 o'clock in the forenoon, for the purposes, as set forth in the attached proxy statement, of electing six directors of the Corporation and of transacting such other business as may properly come before the meeting.

If you do not expect to be present in person at the meeting, the Board of Directors requests that you date, fill in, sign and mail the enclosed proxy.

Stockholders of record at the close of business January 11, 1946 will be entitled to vote at such annual meeting.

R. W. Perkins, Secretary.

Proxy Statement

The Annual Meeting of the Stockholders of Warner Bros. Pictures, Inc. will be held at the principal office of the Corporation at 100 West 10th Street, Wilmington, Delaware, on Tuesday, February 19, 1946, at 11 o'clock in the forenoon. At the time of this statement the only business which the management intends to present, or is informed that others will present, at the annual meeting; [fol. 598] is the election of six directors to serve for a term of two years.

The proxy is revocable and the solicitation thereof is on behalf of the management of the Corporation. Proxy solicitation will be made by mail, telephone (at a nominal cost) and personal solicitation by officers and employees

of the Corporation and by Mr. John E. Morrison, Sr., of 15 Broad Street, New York City, who has been engaged for this purpose. The Corporation will pay Mr. Morrison $1,200, plus his reasonable disbursements. The expenses for preparing, handling and mailing the proxy statement and the proxy and the charges of brokerage houses and other custodians will also be paid by the Corporation.

There are outstanding, after deducting shares held in the treasury, 3,701,090 shares of common stock of the Corporation.

The Annual Report of the Corporation for the fiscal year ending August 31, 1945, which is not part of this proxy statement, is enclosed.

The designation of the proxy committee was made by the Board of Directors of the Corporation, and it is the intention of the proxy committee, unless specifically instructed to the contrary, to vote proxies received in favor of the election of the nominees named below and to vote proxies received, in their discretion, upon such matters not now known or determined which may properly come before the meeting.

The Board of Directors has nominated for re-election to the Board of Directors, to serve for a term of two years, John E. Bierwirth, Waddill Catchings, Robert W. Perkins, Albert Warner, Harry M. Warner and Jack L. Warner.

[fol. 599] Information Concerning Directors.

Name	Principal Occupation	First Became Director	Securities Beneficially Owned at December 1, 1945*
(a) Nominees			
John E. Bierwirth	President and Trustee of The New York Trust Company	1945	None
Waddill Catchings	Producer of radio programs	1925	None
Robert W. Perkins	Vice President, Secretary and General Counsel	1936	500 shares Common Stock
Albert Warner	Vice President and Treasurer	1923	210,000 shares Common Stock
Harry M. Warner	President	1923	150,000 shares Common Stock
Jack L. Warner	Vice President	1923	208,800 shares Common Stock
(b) Other Directors			
Samuel Carlisle	Controller and Assistant Treasurer	1934	None
Stanleigh P. Friedman	Vice President	1931	600 shares Common Stock
Charles S. Guggenheimer	Member of the firm of Guggenheimer & Untermyer, Attorneys	1932	None
Samuel Schneider	Vice President	1944	None
Morris Wolf	Member of the firm of Wolf, Block, Schorr & Solis-Cohen, Attorneys	1928	1,617 shares Common Stock

* Based on information furnished by the respective directors.

All of the nominees, except John E. Bierwirth, have previously been elected Directors of the Corporation by stockholders. For several years prior to 1941, Mr. Bierwirth was a Vice President of The New York Trust Company, and since 1941 has been its President. Mr. Bierwirth was elected a Director of Warner Bros. Pictures, Inc. at a meeting of the Board of Directors on November 23, 1945.

Remuneration of Directors and Officers

The aggregate remuneration, including fixed amounts paid as allowance for expenses (other than travelling expenses), paid by the Corporation and its subsidiaries, directly or indirectly, during the fiscal year ending August 31, 1945, to directors and to person nominated for election as directors, and to officers of the Corporation (as defined [fol. 600] in Regulation X-14) receiving payments of remuneration totalling more than $20,000 during such year, and the excess of such remuneration over that paid during the preceding fiscal year in cases where the remuneration is

more than $20,000, are given below. The fiscal year ending August 31, 1945 included 52 weekly pay days as compared with 53 weekly pay days during the preceding fiscal year.

	Aggregate Remuneration	Excess
Joseph Bernhard*	$157,100	.....
John E. Bierwirth	None	
Samuel Carlisle	48,200	$3,450
Waddill Catchings	1,100	.....
Stanleigh P. Friedman	66,000	.....
Charles S. Guggenheimer	1,100	.....
Robert W. Perkins	66,000	.....
Samuel Schneider	78,900	.....
Herman Starr	71,200	4,950
Albert Warner	104,900	.....
Harry M. Warner	182,500	.....
Jack L. Warner	182,100	.....
Morris Wolf	900	.....

The firm of Friedman & Bareford, of which Stanleigh P. Friedman is a member, was paid the sum of $3,900 for legal services.

The firm of Guggenheimer & Untermyer, of which Charles S. Guggenheimer is a member, was paid the sum of $10,000 for legal services.

The firm of Wolf, Block, Schorr & Solis-Cohen (Philadelphia), of which Morris Wolf is a member, was paid the sum of $21,000 for legal services.

The aggregate remuneration, including fixed amounts paid as allowance for expenses (other than travelling expenses), paid by the Corporation and its subsidiaries during the last fiscal year to the directors and officers of Warner Bros. Pictures, Inc., considered as a group, amounted to $960,000, excluding $34,900 paid to the aforementioned legal firms.

* Joseph Bernhard resigned as officer and director on September 10, 1945.

[fol. 601] Transactions Between the Corporation and Directors

On September 28, 1945 this Corporation entered into an agreement with United States Pictures, Inc., of which Joseph Bernhard is President and owner of 50% of the stock, for the production of six feature motion pictures for distribution by this Corporation. Warner Bros. Pictures, Inc. does not own any of the capital stock of United States Pictures, Inc. The agreement provides generally as follows. The motion pictures are to be produced at the studios of this Corporation and this Corporation agrees to advance 50% of the cost of production of each motion picture by either cash, charges for talent and facilities furnished for the production of the motion pictures, or proportional charges for overhead of studios, etc. Subsidiaries of this Corporation will distribute the pictures throughout the world and retain from the gross proceeds certain direct expenses and certain percentages of the gross

receipts of distribution which vary for different countries. United States Pictures, Inc. is required to provide the other 50% of the cost of production of each of the motion pictures, and may borrow this and pledge as security therefor the negatives, positive prints and all of the net proceeds of distribution after the deductions above referred to.

On November 2, 1945 a loan agreement was entered into between The New York Trust Company, as lender, United States Pictures, Inc., as borrower, and this Corporation, for such part of the cost of production as may be borrowed [fol. 602] by United States Pictures, Inc., which agreement provides for the pledge of the security referred to in the preceding paragraph. After such loans shall have been repaid and Warner Bros. Pictures, Inc. has been reimbursed for the amounts advanced by it, and then United States Pictures, Inc. has been reimbursed for the balance of the amounts advanced by it, then Warner Bros. Pictures, Inc. and United States Pictures, Inc. shall share equally in the remaining net proceeds of distribution.

[fol. 603] In United States District Court

Plaintiff's Exhibit 17

Waiver of Notice

We, the undersigned, being members of the Board of Directors of Warner Bros. Pictures, Inc. do hereby waive all notice whatsoever, of the Special meeting of the Board of Directors of said Corporation, and do consent that the 25th day of September 1945, at 10:00 o'clock in the forenoon, be and hereby is fixed as the time, and 321 West 44th Street, New York, N. Y. as the place for holding the same, and that all such business may be transacted thereat as may lawfully come before said meeting.

(S.) H. M. Warner, J. L. Warner, Albert Warner, S. Carlisle, Stanleigh P. Friedman, R. W. Perkins, S. Schneider, Waddill Catchings, Chas. S. Guggenheimer, Morris Wolf.

[fol. 604] Minutes of a Special Meeting

of the

Board of Directors

of

Warner Bros. Pictures, Inc.

A special meeting of the Board of Directors of Warner Bros. Pictures, Inc. was held at the office of the Corporation, 321 West 44th Street, New York, N. Y., on the 25th day of September, 1945, at 10:00 o'clock in the forenoon.

There were present: Messrs. A. Warner, S. Carlisle, S. P. Friedman, R. W. Perkins, Waddill Catchings, C. S. Guggenheimer, constituting a quorum, and Messrs. W. S. McDonald, L. J. Goffman, and E. K. Hessberg.

Mr. Albert Warner presided as Chairman, and Mr. E. K. Hessberg, Assistant Secretary, acted as Secretary of the Meeting.

* * * * * * *

The Chairman announced that Mr. Joseph Bernhard has resigned as Vice-President and Director of the Corporation.

Upon motion duly made, seconded and carried, it was unanimously

"RESOLVED: That the officers of the Corporation be authorized to terminate the employment agreement of [fol. 605] Joseph Bernhard with the mutual consent of Mr. Bernhard and the Corporation, such termination to be effective on November 7, 1945, and that Mr. Bernhard be paid the sum of Seventy-Eight Thousand ($78,000) Dollars as severance pay, such sum to be payable in twelve (12) monthly instalments commencing on December 1, 1945."

The Chairman reported that Mr. Einfeld who had recently severed relationship with the Company had received severance pay of six (6) months' salary.

There being no further business to come before the meeting, it was, on motion, duly adjourned.

(S.) E. K. Hessberg, Assistant Secretary.

September 10, 1945

To the Board of Directors of
Warner Bros. Pictures, Inc.

I hereby resign as Vice President and Director of Warner Bros. Pictures, Inc., effective immediately.

Very truly yours, (S.) Jos. Bernhard, Joseph Bernhard.

[fol. 606] IN UNITED STATES DISTRICT COURT

PLAINTIFF'S EXHIBIT 123B

Plaintiff's Exhibit 1—2 sheets.

Agreement made and entered into this 24th day of October 1941, by and between Warner Bros. Pictures, Inc., a Delaware corporation, having its principal business office in the City of New York, State of New York, hereinafter for convenience called "First Party," party of the first part and Joseph Bernhard, of the City of New York, hereinafter for convenience called "Second Party," party of the second part,

Witnesseth:

Whereas, First Party is desirous of continuing the sole and exclusive services of the Second Party, now in the employ of the First Party, upon the terms and conditions hereinafter stated,

Now, Therefore, for and in consideration of the sum of One Dollar ($1.00) in hand paid by First Party to Second Party, receipt whereof is hereby acknowledged, and in further consideration of the covenants and agreements hereinafter set forth, to be performed and kept by the respective parties hereto, it is agreed as follows:

1. First Party hereby employs Second Party and Second Party hereby engages his sole and exclusive services to First Party as a Managing Executive with headquarters in New York.

2. The term of this contract will be five (5) years commencing November 1, 1941 and ending October 31, 1946,

and the compensation to be paid by First Party to Second Party for Second Party's services hereunder shall be as follows: Twenty Five Hundred Dollars ($2,500) per week, plus Five Hundred Dollars ($500.00) per week as expenses for entertainment. This shall not cover expenses while traveling.

[fol. 607] In the event that the Second Party shall be physically or mentally incapacitated from performing his duties hereunder, and such incapacity shall continue for a period of sixteen weeks (16) *weeks* or longer, First Party shall have the right, at its option, to terminate employment of Second Party under this agreement.

This contract, on its effective date, shall supersede the exisiting contract between the parties dated March 13, 1939.

In Witness Whereof, First Party has caused these presents to be signed by its duly authorized officer and its corporate seal to be hereunto fixed and Second Party has hereunto set his hand and seal all on the day and year first above written.

Warner Bros. Pictures, Inc., By (signed) H. M. Warner, President, (signed) Joseph Bernhard.

Attest:

R. W. Perkins, Secretary

The parties to the above agreement dated the 24th day of October, 1941, hereby agree that said agreement shall be terminated on November 7, 1945, and thenceforth be of no further force and effect.

Signed in the City of New York this 1st day of October, 1945.

Warner Bros. Pictures, Inc. By: (signed) Stanleigh P. Friedman, Vice President, (signed) Jos. Bernhard.

Attest:

(signed) R. W. Perkins, Secretary

[fol. 608] IN UNITED STATES DISTRICT COURT

PLAINTIFF'S EXHIBIT 18

Waiver of Notice

We, the undersigned, being members of the Board of Directors of Warner Bros. Pictures, Inc. do hereby waive all notice whatsoever, of the Special meeting of the Board of Directors of said Corporation, and do consent that the 28th day of Sept. 1945, at 10:00 o'clock in the forenoon, be and hereby is fixed as the time, and 321 West 44th Street, New York, N. Y., as the place for holding the same, and that all such business may be transacted thereat as may lawfully come before said meeting.

(Sgd.) H. M. Warner, J. L. Warner, Albert Warner, S. Carlisle, Stanleigh P. Friedman, R. W. Perkins, S. Schneider, Waddill Catchings, Chas. S. Guggenheimer, Morris Wolf.

Minutes of a Special Meeting of the Board of Directors of Warner Bros. Pictures, Inc.

A special meeting of the Board of Directors of Warner Bros. Pictures, Inc. was held at the office of the Corporation, 321 West 44th Street, New York, N. Y., on the 28th day of September, 1945 at 10:00 o'clock in the forenoon. [fol. 609] There were present: Messrs. A. Warner, S. Carlisle, S. P. Friedman, R. W. Perkins, Waddill Catchings, C. S. Guggenheimer, Morris Wolf, constituting a quorum, and Messrs. W. S. McDonald, L. J. Goffman and E. K. Hessberg.

Mr. A Warner presided as Chairman, and Mr. E. K. Hessberg, Assistant Secretary, acted as Secretary of the Meeting.

* * * * * * *

The Chairman presented an agreement dated September 28, 1945 with United States Pictures, Inc. formed by Joseph Bernhard and Milton Sperling. The agreement provided for the distribution by Warner Bros. Pictures Distribution Corporation of films to be produced by United

States Pictures, Inc. at this Company's studio in Burbank, Cal.

On motion duly made and seconded, it was unanimously "RESOLVED: That any Vice President of this Corporation be and he hereby is authorized and empowered to execute on behalf of this Corporation, the agreement dated September 28, 1945 with United States Pictures, Inc."

* * * * * * * *

There being no further business to come before the meeting, it was, on motion duly adjourned.

(Sgd.) E. K. Hessberg, Assistant Secretary.

[fol. 610] IN UNITED STATES DISTRICT COURT

PLAINTIFF'S EXHIBIT 107

SCHEDULE H

Warner Bros. Pictures, Inc.
West Coast Studios
Burbank, California

August 12, 1952

Schedule H

United States Pictures, Inc.
c/o Warner Bros. Pictures, Inc.
4000 West Olive Avenue
Burbank, California

Gentlemen:

With reference to that certain agreement between us dated September 28, 1945, as heretofore modified, amended and/or extended (all hereinafter referred to as "Production Agreement"), this will confirm the following further understanding and agreement between us with respect thereto.

As of the date hereof there remain to be produced by you under said Production Agreement three (3) original photoplays and two (2) additional photoplays.

It is mutually desired that you produce for our distribution under said Production Agreement *two (2) further* additional photoplays, upon the same terms and conditions as in said Production Agreement set forth and which are applicable to the remaining two (2) additional photoplays to be produced thereunder as above referred to, and you hereby agree so to do. In order to accomplish the production of the photoplays to be produced by you under said Production Agreement, as amended hereby, additional time will be required. Therefore, in consideration of the mutual promises and agreements of each of us it is [fol. 611] hereby agreed that the term of said Production Agreement shall be extended, subject to the terms and conditions in said Production Agreement contained, to January 1, *1956*.

Except as above specifically set forth, said Production Agreement, as heretofore and hereby amended, shall not be deemed otherwise changed, altered, modified or affected in any manner or particular whatsoever.

If the foregoing is in accordance with your understanding of our arrangements, kindly indicate your approval and acceptance thereof in the space hereinbelow provided.

Yours very truly, Warner Bros. Pictures, Inc., By R. J. Obringer, Assistant Secretary.

Approved And Accepted: United States Pictures, Inc., By Milton Sperling, Its President.

[fol. 612] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 613] In United States District Court

Plaintiff's Exhibit 1

This agreement, made this 28th day of September 1945, by and between Warner Bros. Pictures, Inc., a Delaware corporation duly qualified to do and doing business in the State of California, hereinafter called the "Company",

and United States Pictures, Inc., also a Delaware corporation duly qualified to do business in the State of California, hereinafter referred to as the "Producer", witnesseth:

Whereas, the Producer desires to produce six (6) motion picture photoplays within a period of three (3) years from the date hereof, and, subject to the exigencies of production and other applicable factors, desires to produce two (2) or more of such photoplays in each of said three years, and also desires to arrange for the distribution and release of such photoplays after the completion thereof; and the Company on its part desires to distribute or cause its wholly owned subsidiary, Warner Bros. Pictures Distributing Corporation, or such other distributing agency as it may select, to distribute such motion picture photoplays and, as an inducement to the Producer to enter into such arrangement, the Company has agreed to advance to the Producer, either in cash or facilities or both, toward the cost of producing each of such six motion picture photoplays, a sum up to fifty per cent (50%) of such cost, the Producer to provide the balance of such cost, as more fully hereinafter set forth; and

Whereas, as an inducement to the Company to enter into this agreement, the Producer represents to the Company that it is a corporation duly qualified to do business in [fol. 614] the State of California, that it will be possessed of capital funds in all respects sufficient to enable it to undertake and execute the obligations herein assumed by it, and that it will commence its production of motion pictures with an experienced staff and personnel in all respects adequate to produce motion pictures of the general type and quality of those heretofore produced and distributed by the Company or its distributing subsidiary:

Now, therefore, by reason of the premises, and in consideration of the mutual promises and covenants of the parties hereto, as hereinafter set forth, it is agreed:

First: Producer agrees to produce six (6) motion picture photoplays during the three-year period immediately succeeding the date hereof, with the understanding that the Producer will use its best efforts in view of various production exigencies, and other factors affecting such activi-

ties, to produce two (2) or more motion pictures during each of said three (3) years. Producer agrees that the photoplays herein provided for will be produced by it with all due diligence and in accordance with the current customs and standards of the motion picture industry. All such photoplays shall be produced at the studio of the Company in Burbank, California, or at such other place in the State of California or elsewhere to which the Company may transfer the major portion of its production activities; provided, however, that nothing herein contained shall be construed to prevent the Producer from carrying on certain phases of its production activities at or on certain locations away from the studio of the Company, and within or without the State of California, when "location work" in connection with the production is required elsewhere in the judgment of the Producer.

[fol. 615]

Second: The Company agrees to furnish or make available to the Producer all physical facilities, material, equipment, and, if and when requested, personnel, normally and customarily required for the production of photoplays as contemplated hereunder, all of which are defined for the purpose hereof as "Facilities", which term shall include, without limiting the generality of the foregoing, all items for which the Company is to be reimbursed pursuant to subdivisions 4, and 5 to 10, both inclusive, of paragraph Seventh (a) hereof, all necessary studio facilities, stages, sets, set dressings, props, wardrobe, costume designers, materials, and supplies, including negative raw stock, sound, electrical and other equipment, electricity and other utilities, transportation, labor and other personal services including, but not limited to, writers, composers, musical conductors, cutters or editors, publicity personnel, clerical and secretarial assistants, and other technical assistants needed for the proper production of each of said photoplays, together with all facilities and equipment required or as may be reasonably necessary in connection with the production of said photoplays. The Company further agrees to furnish the Producer with reasonable and necessary business offices and furnishings for its own use in connection with its production activities.

The Company shall keep a record of the cost to it of all "facilities" furnished or made available to the Producer

pursuant to this paragraph Second, according to its regular accounting practices, and in the same manner in which it [fol. 616] keeps account of photoplays produced by it, which cost shall include such an allowance for overhead or general carrying expense as may be determined to be proper by Price, Waterhouse & Company, Certified Public Accountants, to which accounting firm the matter of such overhead expense has been submitted for determination. Both parties agree that the determination so reached by said Certified Public Accountants shall be final and binding upon both parties hereto until the same shall be changed by mutual consent. Such cost (that, the cost of such facilities plus such overhead expense as may be determined in the manner aforesaid), without any profit, shall be charged into the direct cost of producing the photoplays herein referred to.

The Company shall contribute to the financing of the pictures in the manner hereinafter provided in this paragraph Second. It is understood that the Company will lend to the Producer, under the remaining provisions of this paragraph Second, fifty per cent (50%) of the total cost of production of the first picture, and the Producer will provide the remaining fifty per cent. As to each of the following five pictures, Producer agrees that it will provide such additional portion, if any, of the financing (over fifty per cent) as its net corporate surplus will from time to time permit, and the Company agrees to advance to the Producer the balance of the cost of each such picture. The Company expressly agrees that whether the Producer's net corporate surplus will permit it to provide more than fifty per cent of the financing for any picture, and if so how much more, shall be determined by the Producer in its sole discretion, and such determination by the Producer [fol. 617] shall be conclusive and binding upon the Company. In no event, of course, shall the Company be obligated to advance to the Producer more than fifty per cent of the total cost of production of a picture; provided, however, in any event, even though the Producer shall provide more than fifty per cent of the cost of any such picture, the gross receipts, after making the deductions authorized under paragraph Seventh (a) hereof, shall be divided between

the Company and the Producer as provided in subdivision (j) of paragraph Seventh hereof.

The Company shall bill the Producer, weekly, in accordance with the current and established accounting practice of the Company, for a sum equal to one-half of the cost, as above defined, of furnishing or making available to the Producer such "facilities" as the latter may reasonably require in connection with its production activities, less such offsets, if any, as may have accrued to the date of such billings in favor of the Producer and against the Company, and representing the Company's share of costs of production wholly advanced by the Producer as hereinafter provided for.

No facilities furnished for the production of the photoplays contemplated hereunder shall be deemed to constitute a sale by the Company to the Producer of any such facilities, but the said cost or expense thereof to the Company shall be construed as a charge against the production of each photoplay produced hereunder, one half of which is to be paid to the Company by the Producer, and the other one-half of such cost or expense is to be recouped by the Company as hereinafter provided.

[fol. 618] The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are incurred in connection with such production program, the Company shall, weekly, on proper vouchers or billing from the Producer, reimburse the Producer for a sum equal to one-half of such obligations, and, where the Producer shall have acquired a literary property or other item of property expressly for use in one or more of the photoplays herein provided for, and shall have paid the full purchase price thereof, the Company, on proper voucher, shall reimburse the Producer to the extent of one-half thereof; provided, however, if any such literary property so acquired for any photoplay to be produced hereunder, shall not be used in any such photoplay, then, if the Company shall have paid one-half or other proportion of the cost thereof, the Producer shall reimburse the Company for the amount so paid. Where the Producer shall enter into contracts with creative or artistic personnel,

such as, but not limited to, directors, writers, actors, producers and the like, in connection with the preparation and production of the photoplays herein provided for, the Company will, on proper vouchers and billing from the Producer, pay to the Producer a sum equal to one-half of the moneys payable under such contracts, respectively, weekly, or from time to time, as such moneys become payable, but only for such services as may have been rendered by any such personnel in or in connection with any photoplay to be produced hereunder.

If any item of production cost is incurred by Producer partly or entirely on a percentage basis (whether a per-[fol. 619] centage of the gross receipts or of net profits from the picture or of the Producer, or howsoever such percentage may be calculable), then, in like manner as aforesaid, the Company will on proper vouchers and billing from the Producer, pay to the Producer a sum equal to one-half of all such percentage payments which Producer makes from time to time under the terms of any such percentage deals.

The Company agrees that the Producer shall, in the matter of direct employment of personnel, creative or otherwise, enter into contracts of employment in its own name as such employer.

Third: Any stories, literary material and/or screen plays owned by the Company shall not be considered "Facilities" as above defined, and therefore, should the Producer desire to acquire any such for its own use the Producer shall pay the Company therefor, if the latter shall consent to sell the same, such sum as may be mutually agreed upon which in no event shall be less than the cost thereof to the Company. Title to all such literary properties, whether purchased from the Company or elsewhere, shall be taken in the name of the Producer. The actual cost to the Producer of any such literary properties shall be included in the budget for the production of the photoplay in which such property is used.

The Producer may desire to use certain talent in the employ of the Company in the photoplays to be produced by it, and if it shall so request, and if the Company shall consent thereto, the Company will make such talent avail-[fol. 620] able if in so doing, its own production, in the

sole judgment of the Company, will not be delayed, hindered, or interfered with thereby. If the Producer shall make use of any talent in the employ of the Company under certain types of contracts of employment, both parties agree that such talent shall be charged to each respective photoplay, not on the basis of the weekly compensation paid by the Company to such talent under its own contract of employment, but on such basis as will take into consideration the cost to the Company of "idle time" of certain employees under certain types of contracts, and on the same basis and in the same manner and method that the Company uses in charging services of such talent to its own photoplays.

Fourth: The actual production of each of the photoplays herein provided for (subject to such arrangements as may be made between the Company and the Producer respecting the stage and other space where production is to be carried on, the time or periods of use thereof, and the particular facilities reasonably required by the Producer) shall be within the exclusive control of the Producer, including subject matter, selection of stories, preparation of screen play, selection of director, producer, cast, cutting and editing, and the selection of title. Final budget to be prepared by the Producer, for the production of each such photoplay, shall not be subject to the approval of the Company unless such budget shall be in excess of $850,000.00; if in excess of that sum for any photoplay, such budget shall be submitted to the Company for its approval, and thereupon the Company shall have the right to approve or disapprove of such budget as a whole, but will not withhold its approval as to any separate item or items of any such budget, and further agrees that it will not arbi- [fol. 621] trarily or unreasonably withhold its approval of such budget as a whole. The fact that the actual production cost of any given photoplay may exceed the budget thereon as prepared by the Producer, shall not be deemed a default hereunder on the part of the Producer.

Since the photoplays herein provided for are to be produced at the studio and/or studio ranch property of the Company, and since the Company must coordinate the production activities of the Producer with its own pro-

ducing activities, the Producer agrees to notify the Company in writing at least Sixty (60) days before it contemplates it will be ready to commence production of the first photoplay to be produced under this agreement. The Company on its part will use its best efforts to make suitable space and facilities available to the Producer in order that it may commence its own production activities within the time hereinabove provided, but it is agreed that the production activities of the Company shall be given preference and the right of way over those of the Producer hereunder, but, nevertheless, the Company agrees that if it cannot make such space and facilities available to the Producer within the time requested, it will do so as soon thereafter as the Company's producing activities at its studio will permit and will notify the Producer in writing to that effect. The Producer on its part agrees to so conduct its own activities at the Company's studio during the term hereof as to interfere as little as possible with the orderly conduct of the Company's own production activities. Similarly, when the Producer shall desire to commence the production of its second and subsequent photoplays under the provisions hereof it shall give to the [fol. 622] Company a like ninety (90) days' notice in writing of such contemplated commencement of production. The Company on its own part agrees that it will use its best efforts to make such space and production facilities available for such second and subsequent photoplays, subject, however, to the foregoing provisions of this paragraph; provided, however, the Producer agrees that the Company may dismantle and remove all sets or settings used by the Producer, and make such stage space and sets available to the Company for its own use and purposes, within such reasonable time after the Producer shall be finished with the use thereof as the Company may determine; and provided further, that if the Producer shall require any such set or stage space to be maintained and not dismantled for the purpose of making retakes, added scenes, and the like, it shall notify the Company's Production Manager thereof, in writing, promptly upon ascertaining that added scenes, retakes, and the like are, in the Producer's judgment, necessary.

Fifth: In the notice from the Producer to the Company

required under paragraph Fourth hereof, the Producer will notify the Company as to the facilities required by the Producer in connection with the production of each photoplay to be produced hereunder.

Sixth: The parties hereto agree that the photoplays to be produced hereunder shall be distributed by or through Warner Bros. Pictures Distributing Corporation, a subsidiary of the Company, or such other distributor as may be selected by the Company. Such distribution shall be had under an agreement providing for the general release of the photoplays to be produced hereunder in the United [fol. 623] States and Canada with reasonable promptness after delivery of the respective photoplays by the Producer to the Company, taking into consideration the then market conditions and the time deemed necessary by the Distributor for advance promotional or exploitational activities, all such items to be within the discretion and under the control of the Distributor. General release in England and Australia and in other distribution territories shall be made with reasonable dispatch consistent with the then existing laws and prevailing customs or conditions in each respective country or territory, including, but without being limited to, the presence, influence and results of war conditions therein. Regardless of the foregoing, the Company and its said Distributor shall have and is hereby vested with full and complete authority to distribute the photoplays to be produced hereunder and license the exhibition thereof in accordance with such sales methods, policies, and terms as are current from time to time in its own business during the period of distribution of the respective photoplays herein provided for, and in this connection the Company and/or its Distributor shall have the right to modify, amend, cancel, adjust, alter, and revise all agreements, exhibition licenses, sales methods and policies relative to such distribution, exhibition, and/or exploitation of such photoplays as it or either of them may deem proper or advisable, and to adjust or increase or decrease the amount of any allowance to any exhibitor or exhibitors for advertising or for or upon advertising coverages, whether or not included or provided for in any theretofore existing contract, agreement or license, and

with the same effect in each case hereunder as though any [fol. 624] such amendment, modification, cancellation, adjustment, alteration or revision had been included in any such contract in the first instance, and to license the distribution and/or exhibition of the photoplays produced hereunder on a percentage basis or for a flat rental, or both, and/or upon such terms and conditions as the Company and/or its Distributor shall deem proper; provided, however, that the general terms of the selling program of each such photoplay, and the classification to which the Distributor shall assign any such photoplay shall be subject to the approval of the Producer, but this shall not be construed to mean that the Producer shall have the right of approval as to individual contracts. The Company agrees, however, that the sales methods, policies and terms adopted or used in connection with the photoplays produced hereunder, throughout the world, shall be substantially equal to or the same as those applicable to other photoplays of comparable cost and quality produced and/or distributed by or through the Company or any distributor designated by it during substantially the same period.

The terms of said license for distribution and exploitation, and dealing in or with the photoplays produced hereunder in any manner whatsoever, shall be for a period of ten (10) years from the date of the first general release of the photoplays by the Company or its said Distributor in the United States and shall be exclusive with the Company insofar as the six motion picture photoplays herein mentioned are concerned. The Company accepts the said license and agrees to distribute all photoplays produced hereunder by the Producer subject to the terms and conditions hereof. The Company shall have and is hereby [fol. 625] vested with the final decision as to the method or methods relating to the release of each photoplay and its distribution; provided, however, within thirty (30) days after the Producer shall have commenced its principal photography of any picture produced hereunder, the Producer will notify the Company, in writing, of the ninety (90) day period during which the completed photoplay will be delivered to the Company. If such photoplay shall be delivered within said ninety-day period, then the Company, subject to the foregoing provisions of this paragraph

Sixth, shall use its best efforts to generally release said photoplay in the United States within ninety days after the delivery of the completed photoplay to the Company. If the Producer, however, is unable for any reason to deliver the completed photoplay prior to the expiration of the ninety-day period designated in its notice, the Company agrees to use its best efforts to distribute such picture within said period of ninety days plus such additional reasonable time as the Company and/or its Distributor may require by reason of the delay in delivery on the part of the Producer; and provided further, that the Company agrees to use its best efforts in determining the method of release and distribution which will, in its judgment, exploit each photoplay produced hereunder to the maximum extent possible and so as to obtain, in the judgment of the Company, the maximum revenue possible.

Seventh: (a) Out of the gross receipts (as hereinafter defined) derived from the sale and distribution of the photoplays to be produced hereunder, the Company shall retain the sums hereinafter set forth in this subdivision (a) of this paragraph Seventh, (except the moneys set forth in subdivision (4½) of this paragraph, which moneys the [fol. 626] Company shall pay or cause to be paid to the Producer), and the balance of said gross receipts remaining after such sums have first been deducted shall be apportioned and paid as hereinafter provided. The sums to be so deducted and retained by the Company (or by the Distributor, as the case may be), (except as in said subdivision (4½) set forth), are the following:

(1) Twenty per cent (20%) of the sums received and *and* collected by the Distributor for granting to theatres located in Continental United States (including Alaska and Hawaii) or to theatres located in Canada (including Newfoundland) licenses to exhibit the photoplays produced hereunder.

(2) Twenty-five per cent (25%) of the sums received and collected by Distributor for granting to theatres located in the United Kingdom of Great Britain and Northern Ireland, the Isle of Man, the Channel Islands and Eire, licenses to exhibit said photoplays.

(3) With respect to each territory and country mentioned in Schedule A hereto attached, the Company shall retain such a percentage of the sums received and collected by the distributors for granting to theatres located in such territory and country licenses to exhibit said photoplays as is set forth in Schedule A for each such territory and country. The percentages set forth in said Schedule A represent the actual basis on which photoplays of the Company are at the present time being distributed in the territories and countries mentioned in Schedule A, i.e., the distributors in said territories and countries at the present time under their existing agreements with the company retain from the gross receipts derived by them from photoplays distributed by them in said territories and countries the respective percentages of said gross receipts which are recited in said Schedule A. Should said photoplays be distributed in any territories or countries not mentioned in subdivisions (1) and (2) hereinabove or in said Schedule A (hereinafter referred to as "unnamed territories"), then the Company shall retain from the sums received for licensing theatres located in such unnamed territories to exhibit said photoplays an amount equal to the actual cost of distributing said photoplays in such unnamed territories exclusive of the items set forth in subdivisions (5), (6), (7), and (8) hereinbelow.

Should the Producer believe that the actual, total, aggregate cost of the distribution of said photoplays (hereinafter referred to as "distribution cost"), exclusive of the items mentioned in subdivisions (5), (6), (7), and (8) hereinbelow, in said unnamed territories, as well as in all of the territories and countries men- [fol. 627] tioned in said Schedule A, is smaller than the amount actually deducted by the Company pursuant to the provisions of this subdivision (3) hereinabove set forth, then the Producer shall have the right to cause an audit to be made by Price, Waterhouse & Company, Certified Public Accountants, for the purpose of determining what the actual, total, aggregate distribution cost for all such territories and countries

is, and should said Price, Waterhouse & Company determine that said actual, total, aggregate distribution cost for all said territories and countries (exclusive of the items mentioned in subdivisions (5), (6), (7), and (8) hereinbelow) is smaller than the amount deducted and retained by the Company pursuant to the aforesaid provisions of this subdivision (3), then the difference between the distribution cost as so ascertained by Price, Waterhouse & Company, and the amount retained by the Company under said provisions of this subdivision (3) shall be credited to the Producer hereunder, and accounted for accordingly. All audits so made by Price, Waterhouse & Company, at the Producer's request, shall be made at the cost and expense of the Producer. It is understood that the term "distribution cost" as used in this agreement shall be deemed to include all costs of distributing said photoplays in any given country or territory, exclusive of the items mentioned in subdivisions (5), (6), (7), and (8) hereinbelow, and nothing contained in this subdivision (3) shall be deemed to affect, modify or limit the Company's right to retain in full the amounts retainable by it under the provisions of said subdivisions (5), (6), (7), and (8).

(4) The cost to the Company (less the part of such cost repaid to the Company by the Producer pursuant to Paragraph Second hereof) of or incurred in connection with the furnishing of facilities hereunder and, in addition, said cost of facilities shall include the proportionate share, attributable to said photoplays, of the general overhead of the Company's production department, it being agreed, however, that the actual allocation of general overhead, as herein concerned, and for the purpose of this contract, shall be as determined by Price, Waterhouse & Company, Certified Public Accountants, as the proper and fair charge to each photoplay produced hereunder, pursuant to the provisions of paragraph Second hereof, and said overhead charge shall be no greater than said Price, Waterhouse & Company determines should be charged to other photoplays produced by the Company of similar

type and comparable cost and importance during the same fiscal period.

(4½) Out of the gross receipts retained by the Company it shall pay to the Producer, by way of re-[fol. 628] imbursement, a sum equal to all costs and expenses paid or incurred by the Producer in the production of each of the photoplays herein provided for, which costs of the Producer shall include a reasonable allowance for its operating and general overhead in connection with the production of each such photoplay. Such overhead shall include such reasonable executive salaries as the Producer shall pay to Joseph Bernhard and Milton Sperling and other production employees; provided, however, that any part of such salaries which may properly be charged to a picture as a "direct charge" shall not be included in computing the Producer's general overhead.

(5) The cost and expense of all negative and positive prints used in the distribution, exploitation and exhibition of said photoplays; (it being understood, however, that with respect to the countries set forth in Group A of Schedule A hereof, no such print costs shall be retained by the Company and with respect to the countries set forth in Group B of Schedule A, only that part of the print cost or expense shall be retained by the Company which is actually not borne or expended by the Company's subsidiaries who may be distributing said photoplays in said countries).

(6) All costs arising out of and/or losses incurred on account of "kontingent" or "quota" regulations or laws that may exist in any foreign country; costs of superimposing, titling and/or editing prints of said photoplays, cost of sound tracks and of prints (whether negative or positive), and replacements of sound tracks and prints (whether negative or positive); all duties and import costs; all costs (including taxes) of making exchange transactions in transmitting funds to the United States; freight and brokerage expenses; censorship fees; license fees, taxes and other government fees of any nature which may be assessed against said photoplays or the proceeds

thereof excepting net income, franchise, excess profits, corporation or any similar tax payable by the Company and/or Warner Bros. Pictures Distributing Corporation and/or any sub-distributor for the privilege or as the result of doing business, cost of reels, cans and containers, dubbing and/or duping costs; negative insurance; all sound license costs; all costs and expenses incurred in revising or adapting said photoplays to meet censorship and similar requirements in any foreign country, whether or not such revision and modification result in securing the censor's approval; and any other direct expenses which may be incurred in the delivery of the print or prints to the foreign distributor. The costs and/or loss on account of "Quota" or "kontingent" regulations in any country with respect to said photoplays shall be determined in the same manner as such cost or loss is determined [fol. 629] for such country with respect to any other photoplays produced by the Company and distributed in such country simultaneously with said photoplays by the same distributor which is distributing said photoplays.

(7) All costs of direct advertising, publicizing and exploiting the production and distribution of said photoplays.

(8) The cost of checking attendance and receipts at theatres where said photoplays are being exhibited on a percentage basis, i.e., on a basis whereby the theatres pay part of the receipts derived by them from exhibiting said photoplays for the right to so exhibit said photoplays.

(9) Any and all expenses incurred by the Company (less such part thereof repaid to the Company by the Producer pursuant to paragraph Second hereof) for facilities supplied or advances made to or payments made for or on behalf of the Producer pursuant to the provisions of this agreement to the extent that same has not been heretofore specifically covered by any of the subdivisions of this paragraph Seventh (a).

(10) Any and all reasonable and proper expenses not heretofore provided for and incurred by the Com-

pany, in exploiting and attempting to turn the account the photoplays produced hereunder, i.e., without limiting the generality of the foregoing, 16mm rights, television, and other similar or now unknown rights.

The determination reached by Price, Waterhouse & Company with respect to the general overhead or carrying charge, referred to in paragraph Second and subdivision (3) of paragraph Seventh (a) hereof, as a part of the cost to the Company of furnishing "facilities" hereunder, with an explanation as to how such overhead charge has been arrived at, shall be annexed hereto as Schedule B, and shall be identified by the initials of the parties hereto, by their proper officers, as a part of this agreement.

[fol. 630] (b) The term "gross receipts", as used herein, shall be deemed to mean the sums received and collected by the distributor or distributors for granting licenses to exhibitors to exhibit the photoplays produced hereunder, as well as all other sums received and collected by the Company and/or its subsidiaries or affiliates from dealing in and with and exploiting the photoplays produced hereunder.

(c) In determining the amount payable to the Producer hereunder, no part of the sums received from licensing the exhibition of said photoplays in theatres located outside the United States shall be included as part of the gross receipts unless and until such sums shall actually have been received by the Company in the United States of America in United States Dollars. It is understood that sums derived outside of the United States shall be transmitted to the Company in the United States as soon as it may be practicable and possible to make the proper exchange transactions and as soon as said sums may be transferred from such foreign countries in the most economical manner. It is understood, of course, that neither the Company nor the Distributor shall be liable in any respect for any errors of judgment in executing any exchange transactions or in remitting or transferring any funds to the United States. In the event that, because of the laws or currency restrictions or regulations of any country, it shall be illegal or impossible to withdraw any

moneys (hereinafter referred to as "blocked funds") from such country, and in the event that such blocked funds, had they otherwise been transmitted to the United States in United States Dollars would, under the terms hereof, have become a part of the gross receipts and payable to the Producer, then the Company agrees at the written request [fol. 631] of the Producer (provided it may legally do so) either (a) to deposit in a bank or banks, designated by the Producer, in such country, or countries, to the account of the Producer or of such other person or persons whom the Producer may designate, or (b) otherwise to pay to any person or persons in such country or countries whom the Producer may designate, such part of said blocked funds as would have been payable to the Producer hereunder had such blocked funds become a part of said gross receipts.

(d) It is recognized by the parties that in territories and countries located outside the United States it is frequently advisable and preferable, when the objective is to secure the maximum receipts for any photoplay, to license such photoplay in block or together with other photoplays under agreements which specify a total license fee for all photoplays licensed under such agreements and which do not specify what portion of such total license fee shall be allocated to any one photoplay. Accordingly, the parties agree that the Company and/or the Distributor shall, in territories located outside of the United States, have the right to license the distribution and/or exhibition of said photoplays under agreements licensing the distribution and/or exhibition of said photoplays together with other photoplays, not only in instances where such agreements specify what portion of the total license fee is to be allocated to any said photoplay but also in agreements which do not make such specification, and in such event the Company and/or the Distributor shall have the right, subject to the provisions of paragraph Sixth hereof, to allocate to said photoplays such a portion of the total license fee as it and/or they may deem proper under the circumstances, [fol. 632] it being understood, however, that such allocation shall be fair and reasonable in the circumstances.

It is further recognized by the parties hereto that the Company, either directly or through affiliated and/or

subsidiary corporations and/or through contractual arrangements, owns, operates, controls and/or has an interest in theatres located in various parts of the world (hereinafter referred to as "Warner's theatres"). It is agreed between the parties hereto that the Company and/or its Distributor shall have the right to license Warner's theatres to exhibit said photoplays upon such terms and conditions and at such rental and license fees as it and/or they may deem proper in the circumstances, it being understood, however, that the terms on which Warner's theatres shall be licensed to exhibit said photoplays shall be fair and reasonable in the circumstances and shall be reasonably commensurate with the terms on which Warner's theatres exhibit during approximately the same or similar periods other photoplays of similar cost, quality and popular appeal.

(e) Anything herein to the contrary notwithstanding, it is agreed that in such territories outside of the United States and Canada (whether or not such territories are mentioned in Schedule A hereof) where the Company may grant to distributors who are not affiliates or subsidiaries of the Company the right to distribute said photoplays in such territories on a basis whereby such distributors pay for such distribution rights either a flat rental or license fee, or a part of their receipts derived from the distribution of said photoplays, or both, then with respect to such territories (whether or not such territories are mentioned in Schedule A hereof) the net sums actually received by the Company in the United States from such distributors in [fol. 633] United States Dollars shall be calculated as part of the gross receipts hereunder and not the sums received by such foreign distributors from licensing the exhibition of said photoplays in theatres located in such territories (regardless of whether or not such territories are set forth in Schedule A hereof), and furthermore, with respect to such territories, no sums shall be retained by the Company for or on account of "distribution cost", pursuant to the provisions of subdivision (3) of subdivision (a) of this paragraph Seventh hereinabove.

(f) In the event that in the United States or Canada any distributor shall rent any theatre for the purpose of

giving exhibition of said photoplays on a "road-show" basis, as such term is understood in the motion picture industry, then and in such event the profits derived by the distributor as a result of such particular "road-show" exhibition of said photoplays in such particular theatre shall be included in the gross receipts hereunder and the losses suffered from such "road-show" exhibition shall be deducted from the gross receipts. In arriving at such profits and losses, the distributors shall have the right to deduct all legitimate expenses in connection with such exhibition, including rent, advertising, cost of operating the theatre and all other reasonable and customary expenses incurred in connection with such "road-show" exhibition.

(g) It is recognized that at the present time the Company is not engaged itself in the business of distributing photoplays, but is conducting such business through various firms and corporations, some of which are affiliates and [fol. 634] subsidiaries of the Company and some of which are not, and that at the present time the Company licenses such distributors to distribute photoplays produced by it. The parties further recognize that the Company may change its present method of doing business and may in various territories directly engage itself in the distribution of photoplays instead of doing so through such distributors. In the event that the Company shall itself directly distribute the photoplays produced hereunder, then only the sums actually received by the Company for licensing the exhibition of such photoplays in motion picture theatres shall be deemed to be a part of the gross receipts hereunder.

(h) Except as in subdivision (f) hereinabove provided, it is agreed that in no event shall the receipts derived by any theatre from the exhibition of said photoplays be considered a part of the gross receipts hereunder regardless of whether such theatre is or is not one of Warner's theatres, and regardless of whether or not such motion picture theatre is licensed to exhibit said photoplays directly by the Company or by a distributor.

(i) The Company agrees to keep at its office in Burbank, California, complete books of account pertaining to the production cost of said photoplays and to keep at its office,

in New York City, complete books of account pertaining to the distribution of said photoplays together with all vouchers, records and contracts pertaining to production costs and distribution respectively (other than books, records and contracts relating to the foreign distribution of said photoplays, which may be located in foreign countries), all of which shall be open during reasonable hours to inspection and copying by the Producer or its authorized agents, but only with respect to the six pictures to be [fol. 635] produced hereunder. The Company agrees that Producer shall have the right, during reasonable hours, at Producer's cost and expense, to examine the books, records and accounts maintained by the Company for the purpose of inquiring into any records or transactions relating to the six photoplays to be produced and distributed pursuant to the provisions of this agreement.

As soon after completion of production of said photoplays as is reasonably possible, the Producer agrees to furnish the Company with a final and fully itemized statement of production cost, which statement shall be duly certified as correct by one of the Producer's executive officers who shall have knowledge of the facts therein set forth. Commencing sixty (60) days after the general release of said photoplays produced hereunder, the Company shall, at its expense, render to the Producer statements of the receipts, expenditures and computations relative to said photoplays. For eleven (11) months after the first such statement, such statement shall be rendered monthly; for the next three (3) years, quarterly, and thereafter, semiannually, so long as said photoplays are being distributed hereunder.

(j) After making the deductions authorized under subdivision (a) of this paragraph Seventh, the gross receipts, as herein defined, with respect to each photoplay produced hereunder, shall be retained by the Company to the extent of fifty per cent (50%) thereof, and an amount equivalent to fifty per cent (50%) thereof shall be paid to the Producer at the times and in the manner herein provided. In all cases, the deductions authorized under the provisions of this agreement shall be made and the percentages above mentioned shall be paid, retained or determined after such

authorized, deductions have been made from said gross [fol. 636] receipts. There shall be paid to the Producer the share of the gross receipts hereinbefore provided from each photoplay as same are earned, provided that if any photoplay shall result in a net loss then the amount of said loss shall be recouped by the Company from the proceeds of any or all subsequent photoplay or photoplays, in addition to the other charges and costs which it is authorized to retain, from such subsequent photoplay or photoplays until it has recouped such loss. If, within four (4) years after the first general release in the United States of America of the last photoplay produced hereunder, the Company has not recouped all of the moneys owing to it pursuant to the terms hereof, then the Producer shall pay to the Company the amount of such deficiency. Each statement referred to in subdivision (i) of this paragraph Seventh and submitted to the Producer shall cover the preceding accounting period; and when, pursuant to the foregoing provisions in this subparagraph contained, any payment on account of the Producer's percentage or share of the gross receipts of the photoplays produced hereunder is due, the Company shall account to and pay the Producer such accrued sums, if any, and thereafter the Company shall render to the Producer statements and accounting of the receipts, expenditures and computations relative to said photoplays, as in subdivision (i) of this paragraph Seventh provided for, and concurrently with the delivery of such statements the Company shall pay the Producer the amount, if any, shown thereby to be due the Producer hereunder.

(k) For the better protection of the Company and in an effort to assure to the Company repayment by the Producer of any loss incurred in the production of any of the photo- [fol. 637] plays produced hereunder, the Producer agrees that it will, until the Company shall have been repaid the amount of any such loss, and the cost to the Company of all facilities furnished or moneys advanced to the Producer by the Company hereunder in connection with the production of said six photoplays, maintain its corporate existence and franchise in good standing, and that it will not dispose of its assets except in the ordinary course of busi-

ness and then only for money or property at least equal in monetary value to the assets so disposed of. The Producer furthermore agrees that until the Company shall have been repaid any such loss, and the cost to the Company of all facilities furnished and until all moneys advanced by the Company in connection with the production of said six photoplays shall have been repaid in full, it will not assign this contract or any interest therein to any person, firm or corporation without the written consent of the Company having been first obtained. Any attempted assignment contrary to the provisions of this paragraph shall be null and void and no proposed or intended assignee shall acquire any rights hereunder. If the Producer shall, contrary to the provisions hereof, attempt to assign its rights hereunder, then the Company may elect to cancel this contract by notice in writing to the Producer to that effect. It is further agreed that if the two persons or either of them now constituting the major stockholders of the Producer shall, prior to the repayment to the Company of the cost of all facilities furnished and moneys advanced for the production of said six photoplays, sell a major portion (that is, one-half or more of the shares owned by either of said two persons) of the shares of stock owned by them or either of them (whether or not held of record in their own names), except to each other, then the Company herein may [fol. 638] elect to forthwith cancel this contract by notice in writing as to all photoplays not theretofore produced or in course of production. For the purpose of the preceding sentence, a photoplay shall not be deemed "in course of production" unless actual photographing of screen scenes shall have been commenced thereon.

Eighth: In the event that there shall be any dispute or controversy between the Company and Producer on the question of whether the Company has paid Producer all sums shown to be due to Producer by the books, accounts and records of the Company and its distributors, then (at the election of the Producer, such election to be exercised by notice in writing by registered mail to the Company) such dispute and controversy shall be settled by arbitration as follows:

Either party may, by written notice to the other, appoint an arbitrator. Thereupon, within twenty (20) days after

the giving of such notice, the other party shall, by written notice to the former, appoint another arbitrator. In the event that either party hereto, after giving of notice of the appointment of an arbitrator, fails or refuses to appoint a second arbitrator within said twenty (20) days' period, then such second arbitrator shall be appointed by the American Arbitration Association without further notice to such other party, and written notice of such appointment of said second arbitrator shall be sent to the parties hereto. When any two arbitrators have been appointed, as aforesaid, they shall, if possible agree upon a third arbitrator and shall appoint him by notice in writing, signed by both of them, and shall give notice of such appointment to each party hereto; but if twenty (20) days shall elapse [fol. 639] after the appointment of the second arbitrator without notice of appointment of the third arbitrator being given, as aforesaid, then any party hereto may, in writing, request the American Arbitration Association to appoint the third arbitrator, and upon appointment of the third arbitrator (whichever way appointed, as aforesaid), the three arbitrators shall meet and shall give opportunity to each party hereto to present its case and witnesses, if any, in the presence of the other, and shall then make their awards; and the award of the majority of the arbitrators shall be binding upon the parties hereto, and judgment may be entered thereon in any court having jurisdiction. Said arbitration shall be held in the City of New York at such times and places as the arbitrators shall determine, and said arbitration shall in every respect be governed by the arbitration laws of the State of New York. It is distinctly understood and agreed that the arbitrators hereunder shall have no power to determine any other controversy or dispute between the parties hereto relating to any matter other than the one mentioned hereinabove, to-wit, whether the Company has paid the Producer all sums due Producer hereunder, and the award of the arbitrators shall contain a statement to the effect that the said award is limited accordingly. Without limiting the foregoing, it is understood that the arbitrators shall have no power or authority with reference to deciding any controversies or disputes relating to whether the Company has exercised good faith in distributing said photoplays, in allocating any of the receipts

of said photoplays, or in any matter relating to the proper distribution or exploitation of said photoplays. The arbitrators shall have the power to assess the cost of the arbitration, including counsel fees, to either party or to apportion the same in such proportions as they shall determine, among both parties, which said assessment shall be [fol. 640] based on the justification of the parties hereto with respect to the matter arbitrated.

Ninth: In case the production or completion of photoplay productions by the Producer under the terms of this agreement shall be prevented or materially hampered or interrupted by reason of any fire, casualty, strike, unavoidable accident, act of God, war or epidemic, or by the enactment of any municipal, county, state or federal ordinance or law, or by the issuance of any executive or judicial order, whether municipal, county, state or federal, or by any other legally constituted authority or any other cause of the same or similar kind or character beyond the control of Producer or the Company, or by reason of the Producer's or the Company's inability, without its fault, to obtain material, transportation, power or other essential commodity required in the conduct of its business (the continuance of any such event being hereinafter designated as the "casualty period"), then in such event, the Company shall not be obligated to provide any facilities to the Producer, as provided for herein, during such casualty period, or make any further payments on account of production costs, and the Producer shall not be obligated to comply with its obligations hereunder during said period. In this connection, it is specifically understood that continued participation by the Company is dependent upon the continued use and exhibition of the photoplays by motion picture theatres, for which reason it is agreed that if a majority of the motion picture theatres in the United States from which the Company, directly or indirectly, derives revenue from the exhibition of photoplays, or if the majority of the motion picture theatres owned, controlled or operated by the Company, its subsidiaries or affiliates, [fol. 641] shall be closed for any reason whatsoever for a period of three (3) days or more consecutively, then, at the option of the Company, the Company shall not be obligated to provide any facilities or make any payments on

account of production costs for a period equivalent to the length of time said theatres shall be closed, plus a period not to exceed two (2) weeks after such theatres have been reopened (hereinafter similarly designated as the "casualty period"); and the Producer, if the Company does not furnish facilities or pay its share of production costs, as provided for hereunder, shall not be obligated to comply with its obligations hereunder during such period. If, by the continuance of any such "casualty period", production of the photoplays is halted, any picture then in course of production, unless the parties hereto shall otherwise determine in writing, shall remain in status quo until such "casualty period" shall have come to an end (which, in the case of closed theatres from which the Company derives the revenue with which it produces its picture means two weeks after such theatres have been reopened), and thereupon the production of photoplays shall be proceeded with in accordance with the provisions hereof.

Tenth: In the event that the Producer shall default with respect to any of its obligations in connection with the production of any photoplay to be produced hereunder, and the Producer shall not cure such default within thirty (30) days after notice from the Company so to do, then the Company shall have the following rights:

(a) The Company may elect to terminate the obligations of the parties hereto with respect to the completion of such particular photoplay, in which event the Company shall not thereafter be obligated to pro- [fol. 642] vide facilities to the Producer as provided for herein for such photoplay, or to pay to the Producer the costs of production paid by it, and the Producer shall not after such termination be obliged to further comply with its obligations hereunder with respect to the completion of such photoplay, and thereafter the Producer shall have no right, title, or interest in or to said cancelled photoplay or the proceeds derived therefrom. The Company shall have the full right, but not the obligation, to complete the production of said cancelled photoplay without restriction and without obligation or liability to the Producer, and such photoplay shall not, for the purpose of this con-

tract, be included as one of the photoplays which the Producer has undertaken or is required to produce hereunder, and the Producer shall be obligated to produce another photoplay in substitution of the one cancelled; or, as an alternative,

(b) The Company may elect to complete the production of such photoplay, and from the date it makes its election under this subdivision (b) to complete such photoplay, and until the completion of production of such photoplay, the Company shall be in sole, complete and final charge of the production of such photoplay; provided, however, the Producer shall, nevertheless, be entitled to participate in the proceeds derived from the distribution of said photoplay (after the Company shall have recouped therefrom all costs of production and distribution) in such ratio as the proportion of the negative cost of such photoplay contributed by the Producer, bears to the total negative cost of such photoplay, and said photoplay shall be considered one of the photoplays provided for hereunder; or, as an alternative,

(c) The Company shall have the same rights as herein in subdivision (a) of this paragraph Tenth granted the Company except that it shall be optional with the Company as to whether or not the Producer shall produce another photoplay in substitution of the one cancelled or whether the number of photoplays required to be produced hereunder by Producer shall be reduced by the number of photoplays cancelled pursuant to the provisions hereof.

If the Company, pursuant to the provisions of this paragraph Tenth, exercises the right to produce and/or complete the production of any photoplay hereunder, the Company shall have the right to use and/or continue the use of [fol. 643] any talent or other personnel employed by the Producer for use in or in connection with the production of any such photoplay, or to substitute talent in lieu of talent employed by the Producer therefor, as the Company may elect. If the Company shall so request, and in order to make effective the provisions of this paragraph with respect to the use of talent or other personnel by the Com-

pany in producing or completing any such photoplay, the Producer agrees to assign to the Company the contracts of employment with such talent or personnel or execute and deliver to the Company an agreement lending the services of such talent or personnel to the Company, or otherwise make such services available to the Company, for a consideration not in excess of the compensation which the Producer has agreed to pay such talent or personnel under its own contracts of employment with such employees, which compensation the Company agrees to pay to the Producer or the employees involved, as the case may be.

Eleventh: It is further agreed that should the Company, in accordance with the rights granted to it under the provisions of paragraph Tenth hereof, elect to cancel the obligations of the parties hereto with respect only to the photoplay in connection with the production of which the Company was entitled to cancel such obligations, and as a result of such cancellation the Producer is obligated or required to produce a photoplay hereunder in substitution of said cancelled photoplay, then and in that event, and in order that the Company may have adequate time to furnish Producer with the facilities provided for hereunder with respect to such substituted photoplay, the then current yearly period of the term of this agreement, as well as the over-all three year term hereof, shall be deemed extended for a period of not more than sixteen (16) weeks, and any [fol. 644] such substituted photoplay shall be produced upon the same terms and conditions as are herein set forth and applicable to the regular photoplays produced hereunder.

Twelfth: It is further agreed that should the Company, pursuant to the provisions of paragraph Tenth hereof, exercise any right in said paragraph granted to it to produce and/or complete the production of any photoplay hereunder and as a result thereof the Producer shall have no right, title or interest in and to any such photoplay or in and to the proceeds and revenues derived from the distribution and exhibition thereof, then as to all such photoplays the Company shall have the sole, exclusive and unrestricted right to secure copyright and renewal of copyright in its own name or otherwise, as it may desire, wholly

free and independent of the Producer, and to release any such picture as a photoplay of the Company.

Thirteenth: The Company agrees, subject to the provisions of paragraph Twelfth hereof, to secure the copyright registration of all photoplays and trailers thereof produced by Producer hereunder in the U. S. Copyright Office in the name of the Producer, and will advance the costs of such registration and may recoup such cost from the gross receipts of the respective photoplays. It is agreed that the sole and exclusive right, title and interest in and to the copyright renewal of copyrights of said photoplays and trailers thereof, except as herein provided for, shall belong to the Producer. The Producer shall have the sole and exclusive right and privilege to exploit, distribute and exhibit, and cause to be exploited, distributed and exhibited said copyrighted photoplays and trailers in all countries throughout the world, subject, however, to such rights in [fol. 645] connection with the production, distribution, exhibition and exploitation thereof as are granted the Company hereunder, and in no event shall the Producer have any right whatsoever to distribute, exhibit, exploit, traffic in or deal with any said photoplays and/or trailers thereof and/or any component parts thereof during the exclusive distribution period granted the Company under the provisions of paragraph Sixth hereof. The Company further agrees that it will, upon the same terms and conditions aforesaid, duly procure copyrights for each such photoplay and trailer in the countries of North America, the United Kingdom of Great Britain and Ireland, and the countries included in the so-called Berne Convention, and in such other countries throughout the world where copyrights are procurable.

It is specifically understood, however, that the full and complete title in and to the literary material used or which forms the basis of said photoplays and trailers, and all literary, dramatic and every other right of every and any other kind or description in and to said literary material, excepting only the copyrights to the photoplays as aforementioned, shall belong to the Producer.

The Producer understands that the Company has one or more music publishing houses affiliated with it, or as

subsidiaries, as the case may be, and, therefore, the Producer agrees that should any music or musical compositions be composed by or for it for use in, and actually used in, any of the photoplays provided to be produced hereunder, the Company, through such music publishing affiliate or subsidiary as it may select, shall have and is hereby given the first right of refusal or option to publish the same, as well as the right to sell copies, reproductions, recordings and transcriptions thereof, and to license others to use the same in public performances, radio broadcasting, [fol. 646] etc., and to reproduce the same, as aforesaid, on terms and conditions not less favorable to the Producer than comparable and bona fide terms offered to the Producer, if any shall be offered, by music publishing houses not affiliated with the Company.

It is agreed that the Company, in obtaining copyrights in the photoplays and trailers in the name of Producer, as hereinabove provided, is authorized to have noted on such copyright registration that the same is subject to the terms and provisions of this contract.

Negative and positive prints of said photoplays shall, subject only to the terms of this agreement, belong to the Producer. The negative of all photoplays produced hereunder shall be retained by the Company during the full distribution period hereof and during any additional period during which the Company pursuant to the provisions hereof, enjoys any right to reissue said photoplay, as in this agreement provided for.

Fourteenth: The photoplays, subject to the foregoing provisions hereof, shall, when released to the general public, bear at the beginning of the main title on all positive prints of each said photoplay the phrase, "Warner Bros. Pictures, Inc. Presents" or such variation thereof as Company may determine upon, with such trademark on the main and end titles of each said positive print as Company may adopt and use from time to time. The parties hereto further agree that on the main title of all [fol. 647] positive prints of each photoplay produced hereunder Producer shall be given credit as the producer of such photoplays, such credit to be presented in the following language: "A United States Picture Produc-

tion", or such variation thereof as Producer may determine upon, with such trade-mark as the Producer may adopt and use from time to time, said credit to be displayed on a separate title card and shall immediately precede the title card used to accord credit to the individual producer, if any, of such respective photoplay, and in the event individual producer credit is not accorded, said title card shall immediately precede the title card used to credit the director of such respective photoplay; and the aforesaid phrase, "A United States Picture Production", shall be displayed in size type not less than thirty-five per cent (35%) of the size type used for the title of such respective photoplay. It is further agreed that on all so-called paid advertising issued by and under the direct control of Company and used to advertise and exploit the photoplays produced hereunder, the Company shall cause the aforesaid phrase "A United States Picture Production", to appear and be displayed in size type at least equal to twenty-five per cent (25%) of the size type used to display the title of the photoplay involved; and provided further, [fol. 648] on all such paid advertising, Company shall have the right or option to indicate thereon with appropriate language that Company or its subsidiary is the distributor of such respective photoplay, or that such photoplay is being presented or released by or through Company or its distributing subsidiary. Should error occur in billing under the provisions of this paragraph, Company agrees to use all reasonable effort to correct such error within a reasonable time after the occurrence of any such error has been brought to the attention of Company by the Producer.

Fifteenth: The credits on the screen and in paid advertising and publicity shall be determined by the Producer. Not less than (10) days prior to the completion of the principal photography on any photoplay the Producer shall deliver to the Company a written memorandum or directions listing the names of all persons to whom the Producer is required to give such credit. The Producer shall comply with all contracts of employment, guild agreements or agreements with associations of employees with respect to production and other credits in paid advertising, publicity and exploitation pertaining to any of the photo-

plays produced hereunder. Since the production of the photoplays herein provided for is under the direction and control of the Producer, it covenants and agrees to hold [fol. 649] the Company, its agents, assignees and licensees free and harmless of and from, and does hereby indemnify the Company against, any loss, liability or expense, including attorney's fees, which it may suffer or sustain by reason of the failure of the Company to accord credit pursuant to the above-mentioned contracts or agreements.

The Producer will, at the Company's election, defend at the Producer's own cost and expense, all causes of action which may be asserted by persons to whom credit has not been given or to whom credit has been given, pursuant to said written memorandum or directions of the Producer regarding credits. Similarly, the Company agrees to hold the Producer harmless against any loss the latter may suffer or sustain as a result of the failure of the Company, on the film and in paid advertising and publicity, to accord credits pursuant to the Producer's written memorandum or directions with respect to such credits.

Sixteenth: On each photoplay the copyright notice appearing thereon shall indicate copyright ownership in the name of the Producer. The Producer further agrees that all publicity and advertising dealing with the Production, distribution and exploitation of the photoplays produced hereunder shall be done and performed solely and exclusively by the Company's publicity department or its representatives thereof, and the Producer agrees that it will not issue or cause to be issued any advertising and/or publicity statements with respect thereto, but it is agreed that all such advertising shall be subject to the Producer's approval.

Seventeenth: In connection with the distribution of the photoplays throughout the world, with the exception of the United States of America, the Company will advance, [fol. 650] in addition to any other items hereinbefore referred to, the following costs, charges and expenses:

(a) Royalties, if any, payable to manufacturers of sound recording and reproducing equipment on account of distribution in any territory.

(b) Duties, shipping and transportation charges and

insurance charges in connection with the delivery of positive prints, the original negatives, duplicate negatives or duplicating prints to or within any territory.

(c) Censorship charges, license charges or taxes imposed by the government of any territory on the importation of prints or negatives or the exhibition or distribution of the same in such territory.

(d) The cost of re-cutting and re-editing the photoplays for release in any such territory.

(e) The cost of advertising, publicity and exploitation for any territory.

The Company may recoup the amount of the aforesaid advances from the gross receipts and proceeds of the photoplays.

Eighteenth: The Company may recoup from the gross receipts and proceeds of the photoplays produced by Producer hereunder any expenses incurred by the Company or its subsidiary or affiliated corporations in any actions or proceedings filed to recover moneys due pursuant to any agreement relating to the distribution or exhibition of the photoplays; provided, however, that such action or proceeding has been one which the Company has filed believing in good faith that it would recover at least a substantial portion of such money. In this connection, it is agreed that only net collections of any such actions or proceedings, after deducting expenses, shall be included in the gross receipts and proceeds of the photoplays.

Nineteenth: The Company, or its subsidiary or affiliated corporations, or their licensees, may cut and re-edit the photoplays for release in any territory in order to conform to the requirements of the censorship authorities in any [fol. 651] such territory and in order to conform to the peculiar racial or political prejudices likely to be encountered in such territory.

The Company, without the consent of the Producer, may change the title of the photoplays in connection with its distribution in foreign countries, if in the Company's judgment it is necessary or expedient so to do.

The Company may reimburse itself for the cost and expense of re-cutting, re-editing and re-dubbing from the

gross receipts and proceeds of the photoplays as herein provided.

Twentieth: The Company may, limited to the period of distribution referred to in paragraph Sixth hereof, make or authorize others to make foreign language versions of the photoplays without the written consent of the Producer.

The Company may, limited to the period of distribution referred to in paragraph Sixth hereof, cause to be made or authorize others to make foreign language versions of the photoplays, including, but not limited to dubbed versions, superimposed versions and synchronized versions. The Company will advance or obtain the advance of any sums required in the making of such foreign versions, and the Company may reimburse itself for the cost of said versions from the gross receipts and proceeds of the photoplays as herein provided.

The Company may, limited to the period of distribution referred to in paragraph Sixth hereof, also grant to other persons the right to make foreign versions at the expense of the persons making such versions and to distribute such foreign versions in specified foreign countries or terri- [fol. 652] tories, and the net percentages or net sums actually received by the Company or its subsidiary or affiliated corporations from persons making such foreign versions shall be deemed to be the gross receipts for such foreign countries or territories.

If any foreign versions are made, such foreign versions of the original photoplays shall be deemed to be part of the photoplays and shall be deemed to be incorporated in the term "photoplays" and shall be subject to the terms and conditions of this agreement. Any foreign versions made pursuant to the terms of this paragraph shall be limited to the period of time allowed for distribution as provided in paragraph Sixth hereof.

Twenty-first: The Company may cause to be manufactured and distributed in connection with the photoplays advertising material (including lithographs, lobby displays and slides) such as is being used, and has customarily been used, by the Company in connection with photoplays of like character and merit heretofore distributed by it. The

Company, however, shall not charge against the gross receipts and proceeds from the photoplays any sums expended for the manufacture or distribution of such advertising material, but either the Company or its assignee or licensee shall defray the cost thereof. All sums of money received by the Company from the sale or other disposition of such saleable advertising material shall belong to the Company and shall not be accounted for as part of the gross receipts and proceeds hereunder.

Twenty-second: The gross receipts and proceeds of the photoplays shall be received by the Company for the purposes of this agreement. The Company shall not, however, [fol. 653] except as herein expressly provided, be obligated to segregate the gross receipts and proceeds of the photoplays from its other funds.

Twenty-third: The Producer hereby represents, warrants and agrees that the Producer has the full right, power and authority to enter into and perform this agreement and that there is not outstanding any contract or other arrangement of any character with any person that will or might in any way interfere with the full performance by the Producer of its obligations pursuant to this agreement.

Twenty-fourth: If a petition for involuntary bankruptcy shall be filed against the Producer and shall not be dismissed within thirty (30) days after the filing thereof, or if the Producer shall be adjudicated a bankrupt on its voluntary petition; or if a receiver of the assets of the business of the Producer shall be appointed in any bankruptcy or equity proceeding and if such receivership shall continue for more than ten (10) days; or if the petition shall be filed by or against the Producer under the provisions of Chapter 10 or 11 of the Bankruptcy Act and shall not be dismissed within thirty (30) days after the filing thereof; or if any attachment or execution shall be levied upon any negative, sound records or positive prints of the photoplays or upon any property used or intended to be used in the photoplays and shall remain in effect for more than ten (10) days; or if the Producer shall make a voluntary assignment for the benefit of its creditors, then such event shall, at the Company's option, be deemed to constitute an act of default by the Producer under the terms and conditions of this agreement.

Twenty-fifth: The Company will advertise and exploit the photoplays produced hereunder in such manner as is [fol. 654] reasonable, advisable and necessary to obtain the maximum revenue from said photoplays.

Twenty-sixth: The Company further agrees that in connection with each photoplay produced hereunder it will, upon all applicable terms and conditions hereof, furnish the facilities to produce a "trailer" from which prints may be made and distributed or cause to be distributed by the Company, for the purpose of advertising and exploiting each said photoplay, the cost of the facilities furnished by the Company to Producer therefor to be included and considered as a part of the cost of the facilities furnished by the Company hereunder for the particular photoplay involved, as in this agreement provided for.

Twenty-seventh: All notices which the Company is required or may desire to give to the Producer in connection with this agreement shall be sufficient if given by addressing same to the Producer at Warner Bros. Studio, Burbank, Cal., or at such other place as may be designated in writing by the Producer, or at the address of the Producer last known to the Company, or, in the absence of any designated known address, to the Producer, General Delivery, Los Angeles, California; and when same shall be deposited so addressed, postage prepaid, in the United States mail, and/or when the Company shall have delivered same addressed to the Producer at the aforesaid address, and/or when the Company shall have delivered the same, addressed as aforesaid, to a telegraph office, toll prepaid, the Company shall be deemed to have delivered such notice.

Any notices which the Producer may desire or be required hereby to give to the Company in connection with the production of motion picture photoplays herein provided for, shall be deemed sufficiently given if addressed [fol. 655] to: Warner Bros. Pictures, Inc., Burbank, California; any notice which the Producer may desire or be required hereby to give to the Company in connection with the distribution of the photoplays herein provided for, shall be deemed sufficiently given if addressed to: Warner Bros. Pictures, Inc., 321 West 44th Street, New York 18, New York. Any notices so given in either case shall be in writ-

ing and if mailed, shall be deposited in the United States mail in a properly sealed and addressed envelope with the postage prepaid thereon, and if telegraphed such notices shall be delivered to a telegraph office, properly addressed to the Company, for transmission to it with the telegraph charges paid thereon.

Twenty-eighth: In the event of the merger or consolidation of the Company or the Producer with any other corporation or corporations, or the sale by either party of a major part of its assets or its business and good will, this agreement, subject to the provisions of subdivision (k) of paragraph Seventh hereof, may be assigned or transferred to such successor in interest as an asset of the parties so assigning upon such assignee assuming the assignor's obligation hereunder.

Twenty-ninth: For such time as is customary in the motion picture industry, the Company will keep insured at their full insurable risk against loss by fire, theft and other usual insured risks the negative of the photoplays, the positive prints of the photoplays and the sound records of the photoplays. Such insurance shall be payable to the Producer and the Company as their respective interests appear.

If the Company or Producer makes any recovery on any insurance policy issued on the photoplays or issued on [fol. 656] any property, the cost of which is charged to the production of the photoplays in connection with a loss which occurs prior to the completion of the production of the photoplays, the amount of such recovery shall be available for use in connection with the production of the photoplays.

If, after the completion of the production of the photoplays, the Company or the Producer makes any recovery under any insurance policy issued on the photoplays or issued on any property the cost of which is charged to the production cost of the photoplays, or issued on the negative of the photoplays, the amount of such recovery shall be treated as gross receipts and proceeds of the photoplays; provided, however, that the Company will not charge a distribution fee pursuant to paragraph Seventh on the basis of such proceeds.

Thirtieth: The Company may, in the name of the Pro-

ducer or otherwise, take such steps as may seem appropriate to the Company, by action at law or otherwise, to prevent any unauthorized exhibition or distribution of the photoplays, or to prevent any infringement of the photoplays or the copyrights therein or to prevent any impairment of, encumbrance of, or any infringement upon, the rights of the Producer or the Company pursuant to this agreement. The Company shall have the right, in the name of the Company or otherwise, to execute, acknowledge, verify and deliver all instruments pertaining to any action or special proceeding brought for any of said purposes.

All cost, expense (including attorneys' fees), loss, damage or liability suffered or incurred in connection with any such steps by the Company shall be charged against the gross receipts and proceeds of the photoplay involved and shall be paid therefrom as part of the expense of distributing the photoplay pursuant to paragraph Seventh, and [fol. 657] any recovery, loss, costs and expenses thereof, shall be included in "gross receipts", and such recovery shall not be subject to distribution charges.

If either the Company or the Producer suffers any loss of damage (including attorneys' fees, costs and expenses) by reason of any claim, action or proceeding maintained against the Company or Producer or either of them claiming that any of the pictures violates any right or rights of such person (including but not limited to property rights, rights of privacy, rights to be free from defamation, or any other rights, common law or statutory), the amount of such loss or damage shall be considered a cost of production of the particular picture advanced by the Company or the Producer as the case may be, and shall be recouped by the Company or Producer in the same manner as other costs of production advanced by such party are recouped under the provisions of paragraph Seventh. The Company agrees that if any such claim is asserted, or any such action or proceeding is commenced, against the Company, it will notify the Producer, who hereby agrees to defend against the same. The loss or damage hereinabove referred to shall include any settlement which Producer may make of any such claim, action or proceeding.

Thirty-first: If the Producer shall borrow from any bank-

ing association a substantial part of the cost (that is, that part of such cost as the Producer is obligated to pay hereunder) of producing any photoplay herein provided for, the Producer shall notify the Company, in writing, to that effect. If any such loan is arranged for by the Producer, the Company having been notified thereof, the Company agrees, notwithstanding any of the preceding provisions of this agreement, that the Producer, may, for the pur- [fol. 658] pose of obtaining and securing the payment of such loan, pledge or hypothecate the negative of any such photoplay and execute and deliver to any such lending bank an assignment of moneys accruing from the distribution of any such photoplay in accordance with the customary pledge agreement, chattel mortgage or document of similar import demanded by such lending bank in connection with the making of said loan. The Company agrees, in the event of any such loan, to cause its distributing corporation to execute such documents of acknowledgment with said bank as said bank may customarily require of a distributor of a photoplay in connection with such loan agreement. The Company and the Producer furthermore agree that any loan and/or pledge agreement or similar document required by said bank, shall, among other things, provide that out of the gross receipts (as hereinabove in paragraph Seventh (a) defined), derived from the sale and distribution of the photoplays to be produced hereunder, the Distributor shall retain its distribution charges and other costs and expenses in the amounts set forth in subdivisions (1), (2), (3), (5), (6), (7), and (8) of said paragraph Seventh (a), and as set forth in subdivisions (a) to (e) inclusive of paragraph Seventeenth hereof, in all respects the same as if the Producer paid its own cost of production and without the assistance of such bank loan.

Any such loan and/or pledge agreement, or document of similar import required by such bank shall also provide that after the Distributor shall have deducted its aforesaid costs, charges and expenses out of said gross receipts received by it, any part of such gross receipts then remaining in the Distributor's possession shall be paid to said lending bank until such time as the amount of its loan to the Producer, together with the interest thereon, shall have [fol. 659] been fully paid and discharged.

After any such bank loan shall have been so paid, any further moneys received by the Distributor after deducting its said costs, charges and expenses, shall be paid to the Company until the Company shall have been reimbursed for the cost of furnishing "facilities" within the meaning of subdivision (4) of paragraph Seventh (a) hereof; for all cash advances by the Company toward or for such production costs; expenses paid or incurred by the Company (as distinguished from the Distributor) for all costs of direct advertising, publicizing and exploiting the production and distribution of such photoplays, and any and all costs and expenses paid or incurred by the Company and included within the provisions of subdivisions (9) and (10) of paragraph Seventh (a) hereof.

After the Company shall have been fully reimbursed as aforesaid, any further receipts received by the Distributor after its distribution costs, charges and expenses are deducted therefrom, shall be paid to the Producer until its costs of production (exclusive of the principal amount of such bank loan), but including a reasonable allowance for the Producer's operating and general overhead pursuant to subdivision (4½) of paragraph Seventh (a) hereof, shall have been fully recouped by it.

After the Producer shall have been reimbursed for its costs of production, as aforesaid, then any further receipts received by the Distributor less its aforesaid costs, charges and expenses, shall be retained by or paid to the Company to the extent of fifty per cent (50%) thereof, and an amount equal to fifty per cent thereof shall be paid to the Producer, in accordance with the provisions of subdivision [fol. 660] (j) of paragraph Seventh hereof.

If said bank loan shall be made, as aforesaid, then in order that said bank may be reimbursed for the amount of its loan, principal and interest, in accordance with the foregoing, the Company agrees that it will, at the request of the Producer and said lending bank, subordinate the Company's right to recoup or be reimbursed for the amount of all production and/or facilities, costs and/or moneys advanced by it during the production of each of the photoplays provided for hereunder until the loan made by said lending bank, together with the interest thereon, shall have been fully paid and discharged.

If said bank, as a condition precedent to making said loan to the Producer, shall require a commitment to the effect that any photoplay to be produced hereunder, and financed in part with moneys borrowed from said bank, will at any and all events be completed, then, at the request of the Producer and of said bank, the Company agrees that it will, in writing, guarantee to the said bank that any such photoplay will be completed, notwithstanding any of the provisions of paragraph Tenth hereof relating to the default of the Producer in producing or completing any such photoplay, which said agreement guaranteeing completion shall include such terms and conditions as shall be agreed upon between the parties hereto, and as said bank may reasonably require, and shall be submitted to the Company for its approval and execution prior to the execution of this agreement if the first photoplay herein provided for shall be financed in part with any su bank loan.

Thirty-second: Notwithstanding any of the foregoing provisions hereof, the Producer may, so long as it shall not [fol. 661] be in default hereunder, enter into such arrangements as it may deem advisable for the purpose of producing motion picture photoplays elsewhere than at the Studio of the Company for persons other than the Company (hereinafter referred to as "outside photoplays"), and may cause such "outside photoplays" so produced to be distributed by such distributing agency as the Producer may select.

Thirty-third: Each and all of the several rights, remedies and options provided for in this agreement shall be construed as being cumulative, and no one of them as being exclusive of the others or of any right or priority allowed by law.

Thirty-fourth: This agreement shall be construed pursuant to the laws of the State of California with respect to all matters relating to the production of photoplays and pursuant to the laws of the State of New York with respect to all matters relating to the distribution of photoplays.

Thirty-fifth: Nothing in this agreement contained shall be construed so as to require the commission of any act contrary to law, and wherever there is any conflict between any provision of this agreement and any material statute, law or ordinance contrary to which the parties hereto have

no legal right to contract, the latter shall prevail, but in such event the provision of this agreement affected shall be curtailed and limited only to the extent necessary to bring it within the legal requirements.

Thirty-sixth: This agreement shall become effective on and after the 7th day of November 1945.

Thirty-seventh: This agreement constitutes the entire agreement between the parties and cannot be modified, except by a written instrument duly executed by the authorized officers or representatives of each of the parties' [fol. 662] hereto.

In witness whereof, the parties hereto have executed this agreement by their respective officers thereunto duly authorized, the day and year first above written.

Warner Bros. Pictures, Inc., By Stanleigh P. Friedman, Vice President; United States Pictures, Inc., By —— ——, President.

[fol. 663]

SCHEDULE "A"

Countries and Territories	Respective Percentages of Gross Receipts to be Retained Pursuant to Subdivision (3) of Paragraph Seventh (a) of This Agreement
Group A	
Australia, New So. Wales, New Guinea, Western Pacific Isles, Victoria, Western and So. Australia, Northern Territory of Australia, Fed. Capitol Territory, Papua, Queensland and Tasmania	50%
Mexico	50%
New Zealand, Fiji and So. Pacific Isles	45%
Sweden	40
Group B	
Argentine and Paraguay	50%
Brazil	35%
Chile	45%
Cuba	45%
Egypt, Syria, Palestine, Persia, Iraq, Anglo-Egyptian Sudan, Eritrea and Abyssinia, Cyprus	35%
Finland	30%
India, Burma, Ceylon and Afghanistan	35%
Panama & Canal Zone, Costa Rica, Guatemala, Nicaragua, Salvador, Ecuador, Honduras and Br. Honduras	35%
Peru and Bolivia	35%
Puerto Rico and So. Domingo	40%
Trinidad and Tobago, Barbados, Br. & D., Guiana, Isle of St. Vincent, Antiqua, Montsoret, Dominica, St. Kitts and St. Lucia	35%
Uruguay	45%
Switzerland	40%

[fol. 664] Price, Waterhouse & Co.

Schedule B

530 West Sixth Street
Los Angeles

August 30, 1945

Mr. H. M. Warner, President
Warner Bros. Pictures, Inc.,
Burbank, California.

Dear Sir:

In accordance with your request, we have given consideration to the basis of charging independent outside producers for use of facilities and personnel in the production of pictures at the company's West Coast Studios. It is our understanding that the company is considering the advisability of entering into contracts with independent producers and that it is desired to develop a workable, simple plan of procedure with respect to the charges to be made. You have informed us that the company's own volume of production before the strike commenced last Spring will likely continue and that the production by the independent producers will represent an increase in the studio's production volume.

As you know, under present accounting procedure, the studio divides costs into two parts, one being direct charges to specific productions and the other being overhead expenses which are allocated to pictures as a percentage of direct costs. It is our understanding that any services of the studio of the type falling into the category of direct costs will be charged to independent producers, if they use these services, in the same manner as they are charged to the company's own productions.

You have asked us to suggest a suitable basis for allocating overhead expenses to independent producers, having in mind that the extent to which they will make use of the studio facilities and services will vary considerably. It seems to us that overhead charges to independent producers should be scaled according to the use they make of

such services and facilities and overhead accounts into four parts as follows:

(1) Operation and maintenance of studio property and equipment.

The overhead expenses included in this category comprise maintenance costs of buildings and equipment, depreciation thereof, taxes, insurance and miscellaneous other expenses.

[fol. 665] (2) General studio administrative, accounting, etc.

The principal items in this category comprise salaries of the accounting, tabulating, timekeeping, purchasing, telephone and similar departments. This category also includes payroll taxes which the company does not distribute with the related labor charges.

(3) Expenses of sound, special effects, wardrobe, mechanical and other departments not charged as direct costs of pictures.

Expenses included in this category comprise wages of employees that are not absorbed as direct charges to pictures and various expenses of the departments.

(4) Overhead expenses which are considered as not being applicable to outside producers.

The principal item excluded is the amount written off with respect to unused rights and scenarios. There is also excluded the salary of J. L. Warner who will, we understand, not be charged with the responsibility or direction of any of the independent producers' pictures, New York overhead, publicity charges (an expense relating to the company's own productions), cost of screen tests which relate to development of talent for the company, salaries of cast of the company's own stock talent not charged directly to picture costs and miscellaneous other small items.

Based upon the company's experience in the year ended February 24, 1945, during which year the direct costs amounted to some $22,000,000 and the overhead expenses to some $9,300,000, groups (1), (2), and (3) above amounted to 12%, 6%, and 12%, respectively, of the direct charges. For the purpose of allocating such charges on a simple plan rather than one involving considerable detail, groups (1) and (2), which total 18% can be combined to form a basic rate to all producers using the facilities and services of the studio and such rate should be applied to their total direct costs. In addition an overhead charge of 12% should be added to direct charges by the studio to producers for services obtained from the studio. Examples of how these rates might apply are given below for a producer (a) using the physical facilities only, (b) using in addition a few of the technical services available at the studio, and (c) using all studio facilities and services:

[fol. 666]

	(a)	(b)	(c)
Total direct production costs assumed to be $500,000 and furnished by:			
Producer	$500,000	$400,000	
Company	.....	100,000	$500,000
Overhead for:			
Studio facilities (18%)	90,000	90,000	90,000
Services furnished by studio (12%)	.....	12,000	60,000
	$ 90,000	$102,000	$150,000
Effective overhead rate under above circumstances	18%	20.4%	30%

One disadvantage of the foregoing plan may be that independent producers would be discouraged from using the studio's higher priced talent.

If production of pictures at the studio is increased beyond the $22,000,000 mentioned above to say $25,000,000 the percentages mentioned would be reduced to about 10%, 5% and 10% and if it is anticipated that such volume will be reached, it may be feasible to use such reduced rates.

The time element for the use of facilities has not been taken into consideration in arriving at the rates above. It should be realized that an independent producer might re-

tain facilities for a longer period than necessary if the charge therefor is the same regardless of the element of time. It is suggested in order to avoid as much as possible the retention of facilities for an unreasonable length of time, that a maximum period of use be set in each case with a penalty of a certain amount per day in excess of such period.

The studio has experienced in recent years considerable retroactive wage adjustments and perhaps the contracts with independent producers should provide that if the company is subjected to retroactive wage adjustments of any consequence that the appropriate additional charge should be made to the producer.

A more detailed plan than that outlined in this letter could be devised resulting in more accurate allocation of charge to independent producers but the advantage of such a detailed plan might be offset by certain disadvantages such as increased cost of keeping records, etc.

Yours very truly, Price, Waterhouse & Co.

[fol. 667] IN UNITED STATES DISTRICT COURT

PLAINTIFF'S EXHIBIT 4

Warner Bros. Pictures, Inc.
West Coast Studios
Burbank, California

December 6, 1947

United States Pictures, Inc.
c/o Warner Bros. Pictures, Inc.
4000 West Olive Avenue
Burbank, California

Gentlemen:

The following will constitute an agreement between us supplementing and amending certain of the provisions of that certain agreement entered into between us under date

of September 28, 1945 and hereinafter referred to as the "basic agreement".

1. Under the provisions of said basic agreement, you agreed to produce six (6) motion picture photoplays (hereinafter referred to as the "original photoplays") during the three (3) year period immediately succeeding the date of said basic agreement, which three (3) year period will expire on September 27, 1948. You have heretofore produced three (3) of said six (6) original photoplays.

2. In consideration of the circumstances known to each of us and of our mutual consent thereto, it is hereby agreed between us that the three (3) year term above referred to shall be deemed extended until January 1, 1951, and said period, as so extended, shall be hereinafter referred to as the "extended term".

3. You hereby agree that the said remaining unproduced original photoplays will be produced during the extended term, and it is specifically agreed that you will use your best efforts to complete the production of one (1) of such remaining unproduced original photoplays during each of the calendar years of 1948, 1949 and 1950.

4. In addition to the three (3) remaining original photoplays, you hereby agree to produce, within said extended term, four (4) additional photoplays, hereinafter referred to as the "additional photoplays", and which said additional photoplays shall be produced under all of the terms and conditions provided for in the basic agreement and applicable to the remaining original photoplays, except as modified hereby or inconsistent with the provisions hereof. To the end that the production periods for each of the four (4) additional photoplays shall be spaced as evenly as possible within the extended term, the period of time between the date of this agreement and the expiration of the [fol. 668] extended term shall be considered as divided into four (4) equal periods, and you agree to use your best efforts to produce not less than one of the four (4) additional photoplays in each of such four (4) periods.

5. You agree that, prior to the commencement of the principal photography of any of the photoplays hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a

remaining original photoplay or an additional photoplay, as hereinbefore referred to.

6. It is agreed that, with respect to the additional photoplays only, we will advance to you by way of cash or facilities (as referred to in paragraph 2 of the Basic Agreement) one hundred per cent (100%) of the total cost of the production of each of said additional photoplays, and for this purpose the provisions set forth in paragraph 2 and elsewhere in the Basic Agreement shall be deemed modified with respect to said additional photoplays, but only to the extent necessary to effectuate the foregoing purpose. In this connection, it is agreed that you shall not be required to expend out of your own funds any portion of the cost of financing the production of said additional photoplays. It is further agreed that you shall have the right to apportion, in the manner heretofore practiced by you, your annual studio operating expenses or overhead and to charge the same proportionately to the additional photoplay or photoplays produced in each respective year of said extended term as an indirect cost of said photoplay or photoplays, except that the producer's salary paid by you to the producer of any said additional photoplay shall be charged as an item of direct cost thereof. Our obligations to advance cash or facilities, as above referred to, shall include and extend to such indirect cost.

7. It is agreed further that, for the purpose of the additional photoplays only, the provisions of subdivision (a) of paragraph Seventh of the Basic Agreement shall be deemed amended in the following respects:

(a) The reference in subdivision (1) of paragraph Seventh (a) to "twenty per cent (20%)" shall be deemed changed to read "twenty-five per cent (25%)".

(b) Sub-paragraph (3) of paragraph Seventh (a) shall be deemed deleted and the following shall be deemed substituted therefore:

> "(3) Thirty per cent (30%) of the sums received and collected by Distributor for granting to theatres located in all countries and territories of the world, outside of those hereinabove in subdivision (1) and (2) referred to, licenses to exhibit said motion pictures."

[fol. 669] (c) Sub-paragraph (4) of paragraph Seventh (a) shall be deemed deleted and the following shall be deemed substituted therefor:

> "(4) The cost to the Company of or incurred in connection with the furnishing of facilities hereunder and, in addition, said cost of facilities, shall include the proportionate share attributable to each of said additional photoplays of the general overhead of the Company's Producer Department in accordance with its accounting system and practices established for and at the studios of Company, it being understood that under the system of accounting above mentioned the overhead attributable to any photoplay is computed on the basis of the actual or direct cost of producing such photoplay in relation to the total actual or direct cost of producing all photoplays produced during the same fiscal period to which such general overhead is charged; i.e., if the cost of producing any such photoplay is one-tenth (1/10th) of the actual or direct cost of producing all photoplays produced during such fiscal period, then one-tenth (1/10th) of such total overhead is to be charged to such photoplay in addition to the actual and direct cost of production thereof."

(d) Sub-paragraph (4½) of said paragraph Seventh (a) shall be deemed deleted in its entirety, and in this connection the parenthetical references to the said sub-paragraph (4½) contained in said paragraph Seventh (a) or elsewhere in said Basic Agreement shall likewise be deemed deleted.

(e) That portion of sub-paragraph (9) of said paragraph Seventh (a) which is set apart by parentheses, and which reads as follows: "less such part thereof repaid to the Company by the Producer pursuant to paragraph Second hereof" shall be deemed deleted.

8. It is further agreed that the percentages of the gross receipts to be retained by us under the provisions of sub-paragraph (j) of paragraph Seventh of the Basic Agreement shall, with respect to the additional photoplays only, be eighty per cent (80%) rather than fifty per cent (50%),

and the amount therein provided to be paid to Producer shall be twenty per cent (20%) rather than fifty per cent (50%).

[fol. 670] 9. It is agreed, moreover, that paragraph Thirty-first of the Basic Agreement shall, with respect to the additional photoplays only, be deemed deleted in its entirety.

10. It is further agreed that, from time to time during said extended term when you have determined that any story and/or literary property acquired by you, the cost thereof being financed by us, will not be used as the basis of any said additional photoplay, you shall have the right to assign to us all of your right, title and interest in and to any such story and/or literary work in payment of our advances or financing made for the acquisition thereof, which assignment shall not only apply and extend to the basic story and/or literary work acquired by you, but, as well, to any and all story outlines, treatments, screen plays and scenarios written and prepared by you and based thereon, the cost of which was financed by us. It is further agreed, however, that if, at the end of said extended term, you desire to retain any said story and/or literary work acquired by you, the acquisition of which was financed by us as aforesaid, then and in that event you shall have such right, upon the condition that you pay to us an amount equivalent to all sums which we have theretofore advanced to you to acquire said story and/or literary work and for the writing of any story outlines, treatments, screen plays and scenarios written and prepared by you and based thereon, and we agree, should you make such election, to execute such documents as are reasonably necessary in the premises to assign to you such right, title and interest therein and thereto as we may then own.

11. We shall not be entitled to the recoupment or repayment of any moneys advanced by us in connection with any additional photoplay except only out of the proceeds from the distribution of said photoplay. Accordingly, if there is any net loss in connection with any additional photoplay, we shall not be entitled to recoup such loss from the proceeds of any subsequent or prior additional photoplay or original photoplay, and, moreover, you shall not at any

time be obligated to pay to us the amount of such deficiency or any part thereof.

Except as above specifically set forth, said agreement of September 28, 1945 shall not be deemed otherwise changed, modified, amended or affected in any manner or particular whatsoever.

If the foregoing is in accordance with your understanding of our arrangement, kindly indicate your approval and acceptance thereof in the space hereinbelow provided.

Yours very truly, Warner Bros. Pictures, Inc., By —— ——, Assistant Secretary.

Approved and Accepted: United States Pictures, Inc., By —— ——, Its President.

657.

IN UNITED STATES DISTRICT COURT

Plaintiff's Exhibit 22 D

FIRST CLASS
Permit No. 8065
(Sec. 510, P. L. & R.)
NEW YORK, N. Y.

BUY U. S. SAVINGS BONDS
ASK YOUR POSTMASTER

NEW YORK
JAN 14
9-PM
1946

BUSINESS REPLY CARD
NO POSTAGE STAMP NECESSARY IF MAILED IN THE UNITED STATES

4c-POSTAGE WILL BE PAID BY—

WARNER BROS. PICTURES, Inc.

321 WEST 44th STREET

NEW YORK 18, N. Y.

658

IN UNITED STATES DISTRICT COURT

Plaintiff's Exhibit 22 E

NEW YORK, N.Y. JAN 23 12-PM 1947

FIRST CLASS Permit No. 8065 (Sec. 34.6 P.L.&R.) NEW YORK, N.Y.

SAVE THE EASY WAY BUY U.S. BONDS ON PAYROLL SAVINGS

BUSINESS REPLY CARD

NO POSTAGE STAMP NECESSARY IF MAILED IN THE UNITED STATES

4c-POSTAGE WILL BE PAID BY—

WARNER BROS. PICTURES, Inc.

321 WEST 44th STREET

NEW YORK 18, N. Y.

IN UNITED STATES DISTRICT COURT

Defendants' Exhibit B-1-A

(659)

BENEFITS TO AUGUST 31, 1952 TO WARNER BROS. RESULTING FROM PRODUCTION AND DISTRIBUTION OF PICTURES OF INDEPENDENT PRODUCERS

	U.S. PICTURES	CURTIZ PRODUCTIONS	THOMSON PRODUCTIONS	TRANSATLANTIC & CAPRICORN	CAGNEY PRODUCTIONS	FELDMAN PRODUCTIONS	NORMA PRODUCTIONS	B. D. INC.
W.B. OVERHEAD	2,850,384	1,786,092	1,189,032	—	670,051	818,925	463,891	708,968
W.B. DISTRIBUTION ALLOWANCE	4,566,748	2,812,000	1,453,773	910,297	1,321,383	1,497,099	1,125,638	929,513
PRORATA OF PUBLICITY SALARIES	179,870	92,876	107,837	—	—	73,938	58,445	67,695
SOUND LICENSE FEE	29,100	14,985	13,848	3,746	6,019	7,205	2,773	4,961
INTEREST ON ADVANCES	—	141,725	—	—	113,732	52,664	42,125	—
W.B. SHARE OF NET RECEIPTS/DEFICIENCY	(361,892)	(2,242,093)	1,102,068	(375,000)	(668,148)	(576,316)	302,264	559,966
TOTALS	7,264,210	2,605,585	3,866,558	539,043	1,443,037	1,873,515	1,995,136	2,271,083

GRAND TOTAL 21,858,167

IN UNITED STATES DISTRICT COURT

Defendants' Exhibit B-2-A

(666)

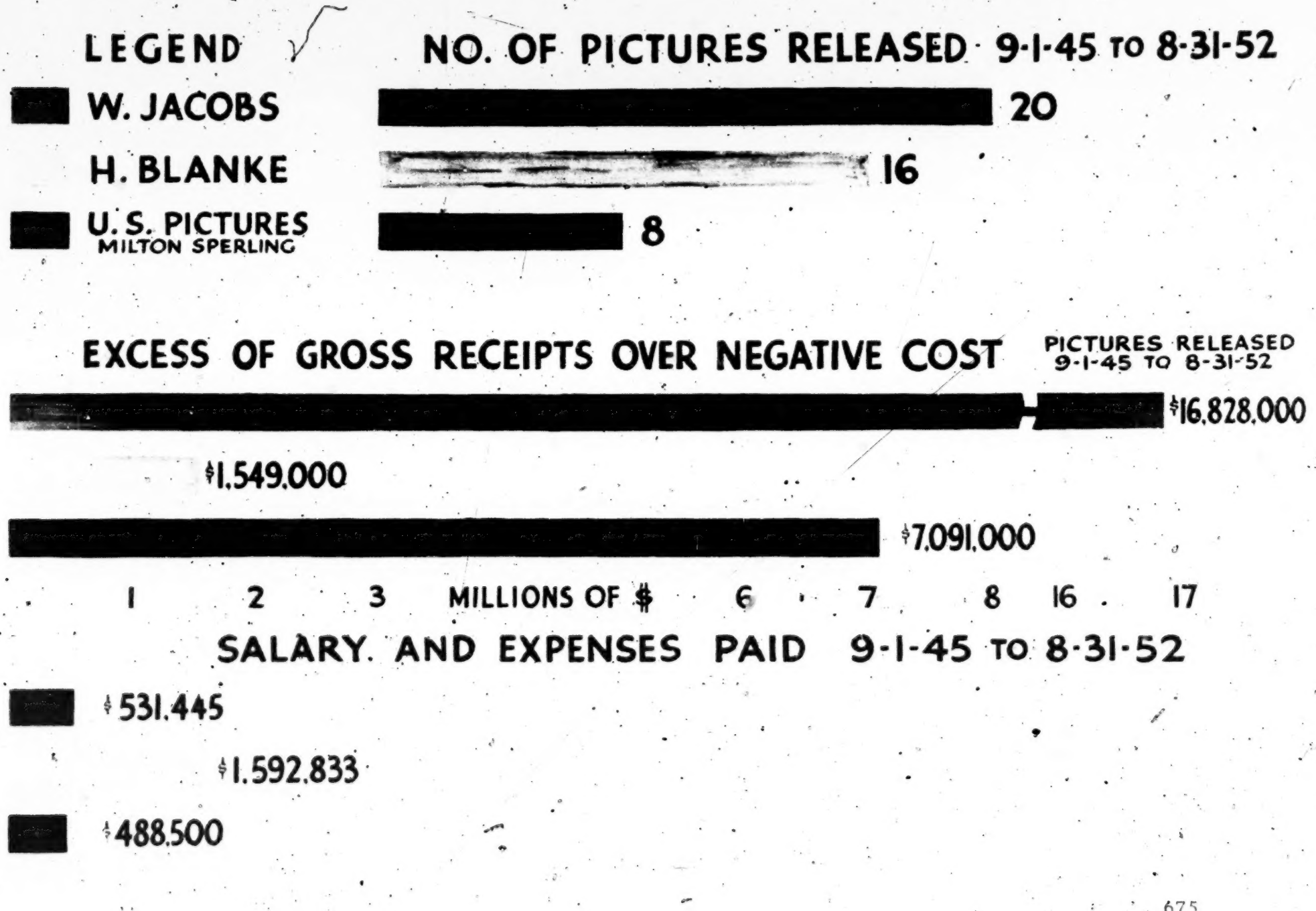
EXCESS (DEFICIENCY) OF GROSS RECEIPTS OVER PRODUCTION COST AT AUGUST 31, 1952

PICTURES PRODUCED BY U.S. PICTURES	GROSS RECEIPTS	PRODUCTION COSTS	EXCESS/DEFICIENCY OF RECEIPTS OVER COST
CLOAK AND DAGGER	$ 4,043,469	$ 2,038,480	$ 2,004,989
PURSUED	3,463,446	1,677,796	1,785,650
MY GIRL TISA	739,220	1,645,067	(905,847)
SOUTH OF ST. LOUIS	2,883,692	1,600,614	1,283,078
THREE SECRETS	1,598,501	798,704	799,797
THE ENFORCER	1,934,742	1,103,072	831,670
DISTANT DRUMS	2,757,564	1,934,804	822,760
RETREAT HELL	1,576,903	1,107,655	469,248
TOTALS	$ 18,997,537	$ 11,906,192	$ 7,091,345

IN UNITED STATES DISTRICT COURT

Defendants' Exhibit B-3-A

(611) - (675)



675

IN UNITED STATES DISTRICT COURT

Defendants' Exhibit B-6-A

(662)

COMPARISON OF BENEFITS TO WARNER BROS. TO AUG. 31, '52 IF ALL U.S. PICTURES PRODUCTIONS HAD BEEN PRODUCED (1.) AS "ORIGINAL" PICTURES, & (2.) AS "ADDITIONAL" PICTURES

U.S. PICTURES PRODUCTIONS	BENEFITS TO WARNER BROS. AS PRODUCED	(1.) IF PRODUCED AS "ORIGINAL"	(2) IF PRODUCED AS "ADDITIONAL"
CLOAK AND DAGGER	1,680,234	1,680,234	1,898,721
PURSUED	1,433,770	1,433,770	1,670,036
MY GIRL TISA	(354,347)	(354,347)	(767,461)
SOUTH OF ST. LOUIS	1,317,471	1,347,668	1,264,731
THREE SECRETS	771,230	792,015	702,373
THE ENFORCER	911,843	828,497	860,309
DISTANT DRUMS	913,017	925,346	913,017
RETREAT HELL	561,891	563,560	561,891
TOTALS	7,235,109	7,216,743	7,103,617

676

IN UNITED STATES DISTRICT COURT

Defendants' Exhibit B-7-A

	43 WEEKS TO 2-26-49	78 WEEKS TO 8-26-50	53 WEEKS TO 9-1-51	52 WEEKS TO 8-30-52
TOTAL W. B. OVERHEAD	$7,339,236	$11,440,018	$7,666,557	$7,576,093
WRITE-OFF OF RIGHTS & SCENARIOS INCLUDED THEREIN	799,710	1,190,575	655,384	331,027
PERCENTAGE THEREOF TO TOTAL OVERHEAD	10.9%	10.4%	8.5%	4.3%

	SOUTH OF ST. LOUIS	THREE SECRETS	THE ENFORCER	DISTANT DRUMS	RETREAT HELL
W.B. OVERHEAD CHARGED TO ADDITIONAL PICTURES AT FULL STUDIO RATES	$474,256	$223,841	$319,310	$560,426	$320,838
PERCENTAGE THEREOF REPRESENTING RIGHTS & SCENARIO WRITE-OFFS	10.9%	10.4%	10.4%	8.5%	4.3%
AMOUNT CHARGED TO U.S. PICTURES FOR RIGHTS & SCENARIOS	$51,694	$23,279	$33,208	$47,636	$13,796

[fols. 678-679] IN UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ARGUMENT AND SUBMISSION—July 5, 1955

(omitted in printing)

[fol. 680] IN UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—May 21, 1956

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the Clerk, and that a Judgment be filed and recorded in the minutes of the Court in accordance with the opinion rendered.

[fol. 681] IN UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 14,334

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC., Appellees

Upon Appeal from the United States District Court for the Southern District of California Central Division

OPINION—May 21, 1956

Before: STEPHENS, FEE and CHAMBERS, Circuit Judges.

JAMES ALGER FEE, Circuit Judge:

This is a stockholders' derivative suit, which was brought ostensibly for the benefit of Warner Bros. Pictures, Inc., a Delaware corporation, by plaintiff Smith, as

Special Administrator of the Estate of Edward S. Birn, deceased, owner of 400 shares of stock therein. The corporation was joined as a defendant with two of its directors and another Delaware corporation, United States Pictures, Inc., along with one Sperling, a director of the latter. The trial court directed that the questions relating to jurisdiction and limitations should be determined before trial on the merits.

Upon such a preliminary hearing, judgment of dismissal of the first cause of action was granted because, when the court realigned Warner Bros., as plaintiff, diversity of citizenship no longer existed, since Delaware corporations [fol. 682] were, respectively, among the plaintiffs and among the defendants.[1]

The second cause of action was dismissed for lack of equity. This cause was asserted against defendants Harry M. Warner and Jack L. Warner alone, and is based upon alleged violations of their duties in a fiduciary capacity as directors of Warner Bros. A third cause of suit was dismissed upon stipulation by the parties.

The facts which were found upon the preliminary hearing were as follows:

"As to the First Cause of Action, the Court Finds:

"I. That this action was commenced by Edward S. Birn, a citizen of the State of New York, and since the commencement of said action, said Edward S. Birn has died and Charles B. Smith, as special administrator of the estate of Edward S. Birn, deceased, has been substituted in his place as plaintiff. That said Charles B. Smith is a citizen of the State of California.

"II. That defendants Harry M. Warner, Jack L. Warner and Milton Sperling, and each of them, are citizens of the State of California, and that the defendants Warner Bros. Pictures, Inc. and United States Pictures, Inc., are, and each of them is, a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and is a citizen of the State of Delaware; and that as the par-

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[1] Smith vs. Sperling, 117 F. Supp. 781.

ties are aligned by the plaintiff, it appears that the plaintiff is a citizen of the State of New York and that the defendants are citizens of the states of California and Delaware, as hereinbefore stated.

"III. That this action was commenced by Edward S. Birn as the owner, during the period of the transactions challenged in the complaint, of four hundred shares of the capital stock of the defendant Warner Bros. Pictures, Inc., and that he is suing derivatively on behalf of and for the benefit of said defendant Warner Bros. Pictures, Inc., and the stockholders thereof; that by the prayer of the complaint a trust is sought [fol. 683] to be impressed on the capital stock and assets of United States Pictures, Inc., in favor of Warner Bros. Pictures, Inc., the agreement between said Warner Bros. Pictures, Inc. and United States Pictures, Inc. referred to in the complaint is sought to be cancelled and terminated and that the defendants Milton Sperling, Harry M. Warner, Jack L. Warner and United States Pictures, Inc. be required to account to Warner Bros. Pictures, Inc., for all losses and damages suffered by it and its subsidiaries and all profits and benefits received by said defendants and that said defendants make restitution accordingly. That the claim set forth in the first cause of action of the complaint, and relief, sought, are for and on behalf of the defendant Warner Bros. Pictures, Inc., and the said Warner Bros. Pictures, Inc. is the real party in interest in said cause of action.

"IV. That the Board of Directors of Warner Bros. Pictures, Inc. is composed of eleven men of whom the defendants Harry M. Warner, Jack L. Warner and their brother Albert Warner, are but three; that the contract in controversy was made and entered into in good faith and without fraud, and said contract was intended by the directors to be of financial benefit to Warner Bros. Pictures, Inc. and its stockholders, and said contract was considered by said eleven members of the Board of Directors of Warner Bros. Pictures, Inc. to be a sound business arrangement for the best present and future interests of the corporation; that in

approving and authorizing the contract, the officers and Board of Directors acted in good faith and exercised their independent business judgment. That at the time of the execution of the contract, Albert Warner, together with the defendants Harry M. Warner and Jack L. Warner, owned less than twenty percent of the outstanding shares of stock of Warner Bros. Pictures, Inc., and that neither corporation nor the directors or officers were shown to be at that time or at any time under the domination or control of the three brothers Warner above named. That neither the stockholders, its officers or directors were, at any time involved in this action, antagonistic to the financial interest of the corporation.

[fol. 684] "V. That it is not true either as alleged in the complaint, or otherwise, that all or a majority or any of the Board of Directors and officers of Warner Bros. Pictures, Inc. wrongfully participated in the acts in the complaint complained of, nor was said Board of Directors dominated or controlled by Harry M. Warner, Jack L. Warner, Albert Warner, Milton Sperling, or any one or more of them. It is not true that if demand had been made upon Warner Bros. Pictures, Inc., that those to whom such application would be made to institute such suit would have been disqualified from faithfully doing their duty as directors and officers of said corporation because of any matters or facts set forth in said complaint, or otherwise. That no demand was made on the directors of said Warner Bros. Pictures, Inc. to institute this action and such a demand would have been futile; nor was any demand addressed to the stockhloders of said corporation. That the stockholders of said corporation were not at the time of the execution of the contract complained of or at any time or at all under the domination or control of the three brothers Warner; nor was said corporation at any time herein referred to in hands or under control antagonistic to the financial interests of said corporation and its stockholders.

"That because of the foregoing findings of fact, Warner Bros. Pictures, Inc. should be by the Court

realigned as a party plaintiff and that upon such realignment it appears that a plaintiff, Warner Bros. Pictures, Inc., is a citizen of the State of Delaware, and that the defendant, United States Pictures, Inc. is a citizen of the State of Delaware.

"That the sole basis of the jurisdiction of this Court is the claim set forth in the complaint of diversity of citizenship and that in view of the realignment of the parties in accordance with these findings, such diversity does not exist."

The record has been examined and gives no occasion for a reversal upon the facts found by the trial court. Only two questions of law remain. The trial court did not attempt to decide the cause on the merits, and this Court makes no such attempt either.

[fol. 685] The key questions are:

First. Where the complaint asserted that the two directors Warner dominated and controlled the corporation Warner Bros. and conspired to misappropriate the assets and business opportunities of the corporation and caused it to enter an utterly improvident contract with United, was the trial court empowered to go behind the allegations and, on the facts found, realign Warner Bros. as a plaintiff? Second. Where United was a party served and appearing in the case and thus before the court, was it proper for the court to dismiss the second cause of action because United was not named in the second cause of action as a party against whom relief was sought therein?

The first question is answered by another. This question is whether Doctor vs. Harrington, 196 U. S. 597, is indistinguishable from the case at bar. If so, the trial court must be reversed as to the first cause of action. In that case the complaint set up that Harrington and the individual defendant had the voting power of a majority of stock, directed the management of the affairs of the corporation, dictated its policy and selected its directors. Without holding a hearing to determine the truth of such allegations, the trial court dismissed the bill for lack of jurisdiction. The Supreme Court of the United States reversed on the ground that, accepting the allegations of

the complaint, there was no ground to realign the parties since the corporation had been used as a tool without independent volition. To like effect are Venner vs. Great Northern Railway Company, 209 U. S. 24, and Central Railroad Company of New Jersey vs. Mills, 113 U. S. 249. It is hardly conceivable that the court in the Harrington case enjoined the trial court, on remand after the reversal therein, to entertain the action even though it should be discovered as a matter of fact that, contrary to allegation, the corporation was not under disabling domination. Judicial power of the federal courts expires when lack of jurisdiction is uncovered at any stage of the proceedings. In the case of Cutting vs. Woodward, 9 Cir., 255 Fed. 633, the court found after trial that a purported sale of assets to the president of the company had been the merest sham and that virtual control of a majority of the Board was exercised by the president. Actual fraud was thus established by the finding. [fol. 686] Appellant cannot complain of divergence of facts found by the trial court here and a different court in a different suit. The courts of the federal system are of special and limited jurisdiction. The first inquiry in any of these tribunals must be directed to the end of discovering whether in fact the judge has the power to entertain and decide the controversy. In the inferior federal courts, this inquiry must be directed to the statutes by which Congress has authorized and empowered them to act.

The preliminary proceeding by the court was thus proper. In any event, Rule 42(b), Federal Rules of Civil Procedure, permits the trial court to isolate any issue and try it first. No jury trial was involved, so that question does not arise. In the event that a trial had been held and the court had found that the corporation was not under domination, it would have been incumbent upon the court to dismiss upon the grounds of lack of jurisdiction. The chances are that, if a trial had been held and the evidence failed to show domination, the determination would have been upon the merits. This circumstance probably explains the lack of precedents. It appears then that the only point of appellant is that the trial court passed upon the question of its jurisdiction at the outset. Appellant would not have benefited by delay.

It must be held ever firmly in the field of view that the question is one of jurisdiction of the District Court. It has consistently been held through the whole history of the federal judiciary that jurisdiction depends upon the facts. If it be assumed that the appropriate allegations or jurisdiction appear in the pleadings and the cause has been fully tried and judgment entered, still, if the facts in the record do not show jurisdiction existed, the judgment must be set aside and the cause dismissed. If the case has been affirmed and the lack of such facts is found by the Supreme Court of the United States, the result must be the same.

A great many of these cases have been decided upon the allegations of the pleadings. If the appropriate allegations are made in the complaint to show the corporation under domination of the individual defendants and the corporation depends upon the same grounds and with the same lawyers as the individual defendants, it is apparent [fol. 687] that a prima facie case is made. But, when the trial is over, the court might well find that the corporation was never dominated, but was at all times a free and uncontrolled agency. When such facts are established uncontrovertibly, jurisdiction is at an end and the parties must be realigned.

There seems to be no ground for saying, because no precedent appears in the books for the trial of these decisive questions at the threshold, it cannot be done. Either jurisdiction subsists or it does not. There is an absolute dichotomy. If any doubt existed, the Federal Rules of Civil Procedure now confirm the right of the court to try any issue separately and in advance of others.

It would be burdensome to the court and litigants if everyone were forced to accept allegations which all knew were false as a basis for jurisdiction and proceed to a long and expensive trial of the case, only to find by this arduous process that the allegations were untrue. Allegations are extremely easy to write. The tendency to abuse of stockholders' derivative actions is too well known to require comment. Once the facts are found, as here, proper realignment must be made and jurisdiction does not exist.

The dismissal of the second cause of action gives us pause. The ground of dismissal assigned by the trial court

was "lack of equity."[2] The ground was apparently based upon the failure of plaintiff to join United States Pictures, Inc., as a defendant in the second cause of action although it was a defendant in the first cause of action and its name appeared in the title. The second cause of action was asserted against Harry M. Warner and Jack L. Warner, citizens of California, as directors and officers of Warner Bros. Pictures, Inc., a corporation of Delaware. Since plaintiff was a resident and citizen of New York, realignment of Warner Bros., as a plaintiff, would not have destroyed jurisdiction. The lack of equity seems to have been based upon the feeling that the cause could not have been completely disposed of without the presence of United [fol. 688] States Pictures, Inc.[3] But the provisions of Rule 19(b), Federal Rules of Civil Procedure, may have been applicable. There it is provided that the court in its discretion may proceed in the action without joining persons "who ought to be parties if complete relief is to be accorded between those already parties," if "their joinder would deprive the court of jurisdiction of the parties before it." Now, "indispensable parties" are excluded from the provisions of this rule. The trial court did indicate that United States Pictures, Inc., was an "indispensible party."[4] However, there is an apparent confusion in this statement. It may be that the trial court considered the question of whether a claim was stated in the so-called "second cause of action" since a holding that United States Pictures, Inc., is an indispensable party may involve a ruling that this count does not state a justiciable claim against Harry M. Warner and Jack L. Warner. But the trial court seemed to feel there were jurisdictional

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[2] 117 F. Supp. 781, 811.

[3] United is referred to variously by the trial court as "not * * * subject to 'necessary joinder' by the terms of Rule 19(a)"; as "clearly a person who 'ought to be' a party within the meaning of Rule 19(b)"; and as "one of the 'parties so indispensable that a court of equity will not proceed to final decision without them'." 117 F. Supp. 781, 810.

[4] 117 F. Supp. 781, 810. See Note 3 above.

implications.[5] No opportunity to amend was given, which normally follows a ruling on motion to dismiss.

This Court does not rule upon the question of whether a claim could be stated against the directors for alleged breach of trust to their own profit, absent United States Pictures, Inc., if Warner Bros. were realigned.[6] It is doubtful whether the trial court ruled on the point, and we do not reach it.

We hold the trial court should have determined the legal sufficiency of the "second cause of action" against the Warners before proceeding to a determination of [fol. 689] the status of the parties and the necessity of joining United States Pictures, Inc., and thus destroying jurisdiction.[7]

Affirmed as to the first cause of action. Reversed and remanded as to the second.

[File endorsement omitted].

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[5] "So in the case at bar, although diversity jurisdiction may exist as to the second cause of action, the question still remains whether the second cause of action is within the equity jurisdiction of this court." 117 F. Supp. 781, 809-810. See State of Washington vs. United States, 9 Cir., 87 F. 2d 421, 427.

[6] Cf. Western States Life Insurance Co. vs. Lockwood, 166 California 185; Reid vs. Robinson, 64 California Appeals 46.

[7] Bourdieu vs. Pacific Oil Co., 299 U. S. 65. Cf. Calcote vs. Texas Pacific Coal & Oil Company, 5 Cir., 157 F. 2d 216; United States vs. McIntire, 9 Cir., 101 F. 2d 650.

[fol. 690] IN UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 14334

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC., Appellees.

JUDGMENT—Filed and entered May 21, 1956

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed as to the first cause of action, and be, and hereby is reversed as to the second cause of action, and that this cause be, and hereby is remanded to the said District Court for further proceedings in accordance with the opinion of this court, without costs to any party.

[File endorsement omitted]

[fol. 691] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 692] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1956

No. 316

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed October 15, 1956

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and is assigned for argument immediately following No. 149. Oral argument in this case will be limited to 45 minutes a side.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(3455-3)

LIBRARY
SUPREME COURT, U.S.

Supreme Court, U.S.
FILED
AUG 13 1956
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.
No. 316

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

HERMAN H. LEVY, and
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SUBJECT INDEX

	PAGE
Citations to opinions below	1
Jurisdiction	2
Statute involved	2
Questions presented	2
Statement	3
Reasons for granting the writ	6
Conclusion	14
Judgment	15

Appendices:

Appendix "A." Statutory provisions, Title 28, Section 1332 (a)(1), United States Code ..... App. p. 1

Appendix "B." Opinion of the United States Court of Appeals ..... App. p. 1

Opinion of the United States District Court ..... App. p. 11

TABLE OF AUTHORITIES CITED

CASES	PAGE
Delaware & Hudson v. Albany & Susquehanna, 213 U. S. 435	6, 8, 10
Doctor v. Harrington, 196 U. S. 579	6, 7, 8, 10
Hawes v. Oakland, 104 U. S. 450	9, 10
Indianapolis v. Chase Bank, 314 U. S. 63	6, 11
JRA Corporation v. Boylan, 30 Fed. Supp. 393, aff'd 109 F. 2d 1018	10
Koster v. Lumbermen's Mutual, 330 U. S. 518	14
Lavin v. Lavin, 182 F. 2d 870	10, 12
New Jersey v. Mills, 113 U. S. 249	6
Railroad v. Grayson, 119 U. S. 240	6
Schmidt v. Esquire, 210 F. 2d 908	11
Venner v. Great Northern, 209 U. S. 24	6, 8

MISCELLANEOUS	
Time, July 30, 1956	12

RULES	
Federal Rules of Civil Procedure, Rule 23(b)	10
Equity Rules of the United States Supreme Court, Rule 94	7, 10

STATUTES	
United States Code Annotated, Title 28, Sec. 1332(a)(1)	2
United States Code Annotated, Title 28, Sec. 1401	12
United States Code, Title 28, Sec. 1254(1)	2

TEXTBOOKS	
Berle and Means, The Modern Corporation and Private Property (1933), pp. 63-64	12
Berle and Means, The Modern Corporation and Private Property, pp. 81-82	13
48 Harvard Law Review, pp. 1, 8-9, Stone, The Public Influence of the Bar	12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.

No. .....

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on May 21, 1956.

Citations to Opinions Below.

The opinion of the District Court, printed in Appendix B hereto, *infra,* page 11, is reported in 117 Fed. Supp. 781. The opinion of the United States Court of Appeals printed in Appendix B hereto, *infra,* page 1, is still unreported.

Jurisdiction.

The judgment of the United States Court of Appeals was entered on May 21, 1956, page 15, *infra*. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254(1).

Statute Involved.

The statutory provisions involved are Title 28, Section 1332(a)(1). United States Code Annotated. They are printed in Appendix A, *infra*.

Questions Presented.

1. Where the directorate of a Delaware corporation which is not dominated and controlled by its president or vice-president, is nevertheless admittedly opposed to a claim asserted by a New York stockholder in a derivative suit in a Federal Court viz.: his corporation is dealing unfairly with a corporation which is owned by the president's son-in-law and causing him to become unjustly enriched at the expense of the stockholder's corporation; where these directors are avowedly hostile to the suit and its objects; where the stockholder's corporation appears in the action, unites with its president and vice-president in resisting the stockholder's claim of illegality, unites with them in opposing his prayer that the Court terminate the dealings and cancel the contract between the two companies and prays the complaint be dismissed; where counsel for the stockholder's corporation admits in open Court "no matter what demand the plaintiff stockholder had made on the directors, they would never have brought this suit"; is not the stockholder's corporation rightly aligned as a defendant in such a suit?

2. May a Federal Court destroy diversity of citizenship and consequently its jurisdiction over this controversy by realigning the stockholder's corporation as a complainant and then dismiss the suit for failure of jurisdiction?

Statement.

Edward S. Birn, a New York citizen and stockholder of Warner Brothers Pictures, a Delaware corporation, invoked the jurisdiction of a California federal court in two causes of action of a derivative suit.

Named as defendants in the first cause were the corporation (Warner, for short), its President and Vice-President, Harry Warner and Jack Warner, both citizens of California; the president's son-in-law, Milton Sperling, a California citizen, and United States Pictures, Inc. (United, for short), a Delaware corporation owned by Sperling and his two children—Harry Warner's grandchildren. [R. 3, 378-380.]

Named as defendants in the second cause were the Warner corporation and Harry and Jack Warner. Sperling and United were not named in this second cause. [R. 11.]

The gist of plaintiff stockholder's claim: A Warner-United joint venture created and continued in a series [Exs. 1, 3, 4, 7 and 107, Schedule H] of Warner-United contracts, entered into successively, terms of which were negotiated and renegotiated by president Harry Warner with his son-in-law Sperling [R. 116, 129, 136], is unlawful and unfair to Warner. It is causing Sperling to become unjustly enriched at Warner's expense. [R. 8-10.] Complainant prayed the Court halt the dealings between the two companies, terminate their relationship, cancel their contract [R. 15], and for other relief.

Warner appeared in the suit and combined with the co-defendants in resisting complainant's claim and prayer: In a joint answer with the brothers Harry and Jack Warner, who were charged with a breach of trust in connection with Warner-United dealings, the Warner corporation denied that complainant was a citizen of New York [R. 20]; denied the truth of his claim [R. 20-24]; pleaded the bar of the Statutes of Limitations of 3 States [R. 24-25], and prayed the complaint be dismissed. [R. 26.] United and Sperling entered a similar plea. [R. 16-20.]

The merits of the controversy, *i.e.*, whether the Warner-United dealings are in fact unlawful and should be terminated and whether the Warner-United contracts should be ordered cancelled, to the extent that they remain unexecuted, were neither reached nor determined: The Court ordered that two issues,

(1) Jurisdiction, and

(2) The bar of the Statutes of Limitations,

be inquired into preliminarily and determined before considering the merits, and directed the parties to appear and present evidence "only as to those issues." [Findings, R. 72.] "Thereupon, evidence on behalf of plaintiff and defendants was offered and received, *the cause argued and submitted upon the two above stated issues only.*" [R. 72; emphasis added.]

Plaintiff established diversity of citizenship between the parties: he proved he was a citizen of New York and that the two corporations and the three individuals who were aligned as defendants were citizens of states other than New York. [R. 73.]

In open Court, counsel for Warner corporation admitted that plaintiff stockholder and his corporation were at odds and occupied opposing positions in the controversy over the legality of the Warner-United relationship [R. 588]; admitted that the Warner directors were hostile and opposed to the objects of the suit: ". . . they would have upheld [the Warner-United arrangement] at any time against any attack by any person, including any group of stockholders" and stipulated that it would have been futile for the stockholders to demand of the directors that the corporation bring the suit. [R. 588-589.]

The defendants also admitted that the brothers Warner owned approximately 15% of Warner's stock and that the rest of the stock is distributed among approximately 30,000 shareholders located in various parts of the world. [R. 120.]

Evidence was also introduced by both parties on the limitations issue which issue was also not reached, for the judge concluded:

1. To change Warner's position in the suit from defendant to plaintiff, align it as such and thereupon dismiss the First Cause of Action (in which United is a defendant) for failure of jurisdiction.

2. To dismiss the Second Cause of Action (in which United is *not* named a defendant) for the reason that the cause could not be determined without the presence of United as a party[1] and consequently that cause was "without equity." [R. 77-79.]

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[1]"No extended discussion is necessary to point out why a decree by this Court as to the second cause of action without the presence of United before the Court would leave the controversy 'in such a condition that its final determination may be wholly inconsistent with equity and good conscience.'" (Opinion of the District Court, 118 Fed. Supp. at p. 810, Appendix B, p. 63.)

The Court of Appeals "Affirmed as to the First Cause of Action. Reversed and remanded as to the Second." (Opinion, Appendix B, p. 10.)

Reasons for Granting the Writ.

1. In holding that, in a derivative suit brought in a federal Court a stockholder's corporation is properly aligned as a defendant only if the stockholder succeed in establishing that the corporation is dominated and controlled by the co-defendants who are accused of injuring it, otherwise the corporation must be realigned as a plaintiff and if such realignment destroys diversity of citizenship, the suit must be dismissed for failure of jurisdiction, the Court below has decided an important question of law in a manner directly in conflict with the decisions of this Court in: *New Jersey v. Mills,* 113 U. S. 249; *Railroad v. Grayson,* 119 U. S. 240; *Doctor v. Harrington,* 196 U. S. 579; *Venner v. Gt. Northern,* 209 U. S. 24, 31, 32; *Delaware & Hudson v. Albany & Susquehanna,* 213 U. S. 435, 451; *Indianapolis v. Chase Bank,* 314 U. S. 63.

With deference to the Court below, we maintain that in none of the three cases cited in the opinion below (Appendix B, p. 6) namely, *Doctor v. Harrington, Venner v. Gt. Northern,* and *New Jersey v. Mills, supra,* did this Court so hold or suggest. To the contrary, in *New Jersey v. Mills* (1884), *supra,* this Court declared the stockholder's corporation to be "rightly and necessarily" a defendant although there is not a word in the opinion that either holds, suggests or implies that the co-defendants in that case dominated and controlled the stockholder's company.

And in the later case of *Railroad v. Grayson* (1886), *supra,* cited in *Indianapolis v. Chase Bank* (1946),

supra, this Court pointed out that the stockholder "does not represent the company in its corporate capacity and has no authority to do so"; in bringing the suit, the stockholder is suing not for his corporation "but for himself" albeit a decree in his favor is advantageous to the company; "as a stockholder he is seeking protection from the illegal acts of his own company" as well as the illegal conduct of others and this Court again declared that the corporation is "rightly and necessarily a defendant." (119 U. S. at 244.) And not a word in its opinion in that case which suggests that the co-defendant dominated or controlled the stockholder's company.

In *Doctor v. Harrington* (1905), *supra,* this Court again declined to class the stockholder's corporation otherwise than as a defendant. It reversed the District Court which had realigned the corporation as a plaintiff, thus placing New York citizens on both sides of the litigation and thereby precluding assumption of jurisdiction based on diversity of citizenship. The Court's grounds for reversing and restoring diversity, and consequently jurisdiction, were (1) that a stockholder who sought protection from claimed illegal acts of his corporation had a right to sue his company and name it a defendant, and (2) when such a suit is between citizens of different states, it may be brought in a Federal Court.

The Court pointed out that it had always recognized such a stockholder's right to sue his company (196 U. S. at 588); that it had set forth in its Equity Rules namely Rule 94 what a stockholder's bill in such a suit is required to exhibit. The Court went on to hold that the stockholder's bill in the *Harrington* case satisfied the requirement of Rule 94, for the bill exhibited that the suit was not collusive; that complainants were unable to obtain

redress from the company or its stockholders because the directory was "under the absolute control and domination of the defendant, John J. Harrington and that said Harrington, by reason of having possession of a majority of the capital stock of said corporation" likewise controlled "the action of the stockholders"; that Harrington had declined to redress the wrongs of which complaint was made. (196 U. S. at 588.)

In other words, these allegations of "domination and control" were not a jurisdictional *sina qua non;* their function was (as the Court pointed out in *Venner v. Gt. Northern, infra,* and *Delaware & H. v. Albany & Susquehanna, infra*) to exhibit to a Federal Court ***which had jurisdiction*** that the plaintiff had either complied with the requirements set forth in the Equity Rule 94 or had exhibited circumstances which excused such compliance.

In *Venner v. Gt. Northern* (1907), 209 U. S. 24, this Court again declined to regard the stockholder's corporation otherwise than as a defendant.

In that case it was argued (seemingly as it was in the *Harrington* case) that the Circuit Court "was without jurisdiction and should have remanded it to the State Court for two reasons. First, because upon a proper alignment of the parties there was not a controversy between citizens of different states. Second, because the cause of action as disclosed by the pleadings showed that the Circuit Court had no jurisdiction over the subject matter" (209 U. S. at 31), *i. e.,* because the plaintiff had failed to comply with Equity Rule 94 in that "Whether or not he was a stockholder at the time when the alleged wrongful acts were committed by the defendants does not appear by any allegations in the complaint" (*id.* at 29).

"These reasons" said Mr. Justice Moody, "are entirely independent of each other and require separate consideration. First was there a controversy between citizens of different states?" (*id.* at 31). Justice Moody went on to point out that while the Court may realign parties and place them "on the side where their interests in and attitude to the controversy really places them and then may determine the jurisdictional question in view of this alignment" (*id.* at 31-32) the fact that "it would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail" . . . "is not enough" to warrant its being regarded other than as a defendant where (as in the case at Bar) the corporation admittedly "unites with the other defendants in resisting the plaintiff's claim of illegality and fraud"; where (as in the case at Bar) the defendants "are alleged to have engaged in the same illegal conduct and the injury is alleged to have been accomplished by their joint action." Under the circumstances, declared the Court "the plaintiff's controversy is with both, and both are rightfully and necessarily made defendants and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant" (*id.* at p. 32).

Coming to the second inquiry, namely, "Did the Circuit have jurisdiction of the subject matter of the litigation?", Mr. Justice Moody rejected the appellant's argument (*id.*, at 33) "that a compliance with that rule [Rule 94] is essential to the jurisdiction" and said (*id.*, at 34) "Neither the rule nor the decision from which it is derived[2] deals with the question of jurisdiction of the Courts, but only prescribes the manner in which jurisdic-

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[2]*Hawes v. Oakland*, 104 U. S. 450.

tion shall be exercised." The learned Justice went on to point out "The objection that plaintiff has failed to comply with Equity Rule 94 may be raised by demurrer, but the admitted power to decide this question is also an admission that the Court has jurisdiction of the case." (*id.*, at 35.)

In *Delaware & Hudson v. Albany & Susquehanna* (1908), 213 U. S. 435, this Court had occasion to refer specifically to the allegations in the *Harrington* case with respect to "domination and control" and said of these allegations, that their purpose and effect was "to show a case not of compliance with Rule 94, but circumstances which excused from such compliance." (213 U. S. at 449.)

Rule 94 is now incorporated in R. 23(b), F. R. C. P. In its present form the rule is declaratory of this Court's decisions in both *Hawes v. Oakland*, 104 U. S. 450, and *Delaware & Hudson v. Albany & Susquehanna, supra,* in that a plaintiff is now required to show either that he tried to get his corporation to remedy the wrong complained of or that such effort would be vain and futile. As pointed out in the Statement, *ante,* defendant's counsel in the case at bar stipulated that such efforts on the part of petitioner would have been futile. [R. 587.]

2. The decision of the Court below is directly in conflict with decisions of the Second Circuit Court of Appeals on the same subject in *JRA Corp. v. Boylan,* 30 Fed. Supp. 393-394, affirmed on opinion below in 109 F. 2d 1018, and in *Lavin v. Lavin,* 182 F. 2d 870. This conflict was conceded by the District Judge in his opinion, 117 Fed. Supp. 781, at pp. 805-806. Appendix, pp. 53-55.

The decision below is also directly in conflict with the decision of the Seventh Circuit Court of Appeals in

Schmidt v. Esquire (1954), 210 F. 2d 908, 912, in which that Court stated: "It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal of the corporate management to sue results from fraudulent or other improper motives."

3. The error of both Courts below in realigning Warner Corporation as a plaintiff thus destroying diversity becomes clear when this Court's language in *Indianapolis v. Chase Nat'l Bank*, 341 U. S. (1941) 63, is adapted to the realities of the present case and it is seen that the question which "permeates this litigation" (*id.*, at 72) is, should the Court terminate and cancel the Warner-United arrangement as unlawful and unfair to Warner and compel the co-defendants to account for injury they are alleged to have caused.

This is the "primary and controlling matter in dispute" (*id.*, at 72) with respect to which the plaintiff stockholder is admittedly on one side, and the Warner Corporation and the co-defendants are, by their own admission, indissolubly united on the other side. "Plainly, therefore," (*id.*, at 74) the Warner Corporation and the co-defendants "are, colloquially speaking, partners in litigation." What the plaintiff wants, the Warner Corporation and the co-defendants do not want. Yet by the decision of the Court below the plaintiff and the Warner Corporation were ranged alongside one another and "made to have a common interest" and objective when, in reality, they are opposed to each other and are poles apart in what they seek. "Therefore, if regard be had to jurisdictional integrity" the Warner Corporation and the co-defendants "are on the same side of the controversy not only for their own purposes but for purposes of diversity jurisdiction." (*id.*, at 74.)

4. Clearly the question is of importance since it affects substantially the rights of some 8,000,000[3] citizens who have invested in shares of publicly owned American companies a substantial portion of their savings,[4] to obtain relief from corporate practices which are evil;[5] practices which result in unlawfully diluting and watering down the stockholder's rightful share of his company's capital and its profits.[6]

We urge that it is no answer to say to this citizenry that the Courts of the States are there to protect them, if for no other reason (and other reason there is) than the bald fact that State Courts are not always available, and that Congress has recently recognized that fact when it amended[7] the venue statutes in order to make available a federal forum for the stockholder who every so often faced a situation in which no State Court would hear him because he could not find within the territorial borders of any one State and therefore could not effect service of process on, his corporation—an indispensable party—*and* the officers and directors whom he accused of despoiling it.

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[3]"The U. S. now had 8,630,000 stockholders in publicly held companies, one-third more than four years ago. So New York stock exchange President Keith Funston announced this week.—Just over half (56.1%) of U. S. stockholders are women." Time, July 30, 1956.

[4]"Within recent years approximately half of all the savings of the community have gone into corporate securities—almost entirely the securities of Quasi-Public Corporations." The Modern Corporation and Private Property, Berle and Means (1933) pages 63-64.

[5]"Featherbedding occurs at top level management and extends down to the rank of foremen," said A. I. M. in a report to its 17,000 members. And one of the biggest causes of featherbedding is nepotism. In more than half of the 23,000 U. S. companies A. I. M. [American Inst. of Management] studied, an executive had put his sons, cousins, brothers—even an assortment of relatives—on the payroll. Time, May 14, 1956.

[6]Stone. The Public Influence of the Bar, 48 Harv. L. Rev. p. 1 at pp. 8-9.

[7]§1401, Title 28, U. S. C. A. See *Lavin v. Lavin,* 182 F. 2d 870.

Unless the Court settles this question, the doors of every Federal Court in the Ninth Circuit will be closed to a stockholder though he succeed in extracting admissions from members of his corporation's directory—like the plaintiff did in the case at bar—: from one member, that the directory is in effect a self-perpetuating body, *i. e.*, each year it authorizes the submission to the stockholders of a list of candidates for election to the board; appoints a proxy committee and authorizes the solicitation of stockholders' proxies[8] [R. 261-264]; from others who are employed by the company at substantial salaries or retainers, admissions that their continued connection with the company depends on their not becoming *persona non grata* to the brothers Warner who between them have a "working control" of the company,[9] from others that their presence on the board is virtually at the brothers' pleasure. [R. 264, 285.]

Admissions like the foregoing will fall short of proof "by a preponderance of the evidence"[10] that the directory was "dominated and controlled" by the alleged wrong doers because, as appellees successfully contended in the Court below, men who possess personal strength and in-

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[8]"In selecting the proxy committee the corporate management is in a position to name the men who will be subservient to it;—The normal apathy of the small stockholder is such that he will either fail to return his proxy, or will sign on the dotted line returning his proxy to the office of the corporation—the proxy votes are then used to rubber stamp the selections already made by those in control." The Modern Corporation and Private Property, Berle and Means, pages 81-82.

"The proxy machinery has become one of the principal instruments not by which a stockholder exercises power over the management of the enterprise but by which his power is separated from him." *Id.* at 139.

[9]*Id.* at p. 80.

[10]Opinion of the District Court 117 Fed. Supp. at 788, Appendix B, p. 15.

tegrity cannot be controlled by such venal considerations as substantial annual salaries or retainers from the corporation.

In short, the decision of the Courts below, in essence, require the stockholder to demonstrate to an almost mathematical certainty that the ethical current in each of his company's directors is not adequate to overcome the promptings of self—a virtually impossible task; a task which, with deference to the Courts below seems decidedly out of harmony with this Court's recent observations:

> "It has been the whole course of our law to break down the barriers against calling corporations to account in all states where they may do wrong in doing business."

Mr. Justice Reed in *Koster v. Lumbermen's Mutual,* 330 U. S. 518 at 538:

> "The whole trend of recent Congressional legislation has been to protect corporate stock and security holders. See, *e. g.,* Securities Act, 1933. But this legislation was not intended as a complete substitute for the antidote provided by stockholders' suits for the dangers inherent in the modern development of frequent conflicts of interest between corporate owners and corporate managers."

Mr. Justice Black in the same case at page 532.

Conclusion.

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

HERMAN H. LEVY, and
MORRIS J. POLLACK,
MOSS, LYON & DUNN,
Counsel for Petitioner.

Judgment.

United States Court of Appeals for the Ninth Circuit.

Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant, vs. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Appellees. No. 14334.

JUDGMENT.

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed as to the first cause of action, and be, and hereby is reversed as to the second cause of action, and that this cause be, and hereby is remanded to the said District Court for further proceedings in accordance with the opinion of this court, without costs to any party.

(ENDORSED) Judgment
Filed and Entered: May 21, 1956
PAUL P. O'BRIEN, Clerk.

APPENDIX "A."

"§1332. Diversity of citizenship; amount in controversy (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $3,000 exclusive of interest and costs, and is between: (1) Citizens of different States: . . ."

APPENDIX "B".

Opinion of the United States Court of Appeals.

In the District Court of Appeal of the State of California, Southern District of California, Central Division.

Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant, vs. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Appellees. Civil No. 14,334.

Filed May 21, 1956.

BEFORE: STEPHENS, FEE and CHAMBERS, Circuit Judges

JAMES ALGER FEE, Circuit Judge:

This is a stockholders' derivative suit, which was brought ostensibly for the benefit of Warner Bros. Pictures, Inc., a Delaware corporation, by plaintiff Smith, as Special Administrator of the Estate of Edward S. Birn, deceased, owner of 400 shares of stock therein. The corporation was joined as a defendant with two of its directors and another Delaware corporation, United States Pictures, Inc., along with one Sperling, a director of the latter. The trial court directed that the questions relating to jurisdiction and limitations should be determined before trial on the merits.

Upon such a preliminary hearing, judgment of dismissal of the first cause of action was granted because, when the court realigned Warner Bros., as plaintiff, diversity of citizenship no longer existed, since Delaware corporations were, respectively, among the plaintiffs and among the defendants.[1]

The second cause of action was dismissed for lack of equity. This cause was asserted against defendants Harry

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[1]Smith vs. Sperling, 117 F. Supp. 781.

M. Warner and Jack L. Warner alone, and is based upon alleged violations of their duties in a fiduciary capacity as directors of Warner Bros. A third cause of suit was dismissed upon stipulation by the parties.

The facts which were found upon the preliminary hearing were as follows:

"As to the First Cause of Action, the Court Finds:

"I. That this action was commenced by Edward S. Birn, a citizen of the State of New York, and since the commencement of such action, said Edward S. Birn has died and Charles B. Smith, as special administrator of the estate of Edward S. Birn, deceased, has been substituted in his place as plaintiff. That said Charles B. Smith is a citizen of the State of California.

"II. That defendants Harry M. Warner, Jack L. Warner and Milton Sperling, and each of them, are citizens of the State of California, and that the defendants Warner Bros. Pictures, Inc. and United States Pictures, Inc., are, and each of them is, a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and is a citizen of the State of Delaware; and that as the parties are aligned by the plaintiff, it appears that the plaintiff is a citizen of the State of New York and that the defendants are citizens of the State of California and Delaware, as hereinbefore stated.

"III. That this action was commenced by Edward S. Birn as the owner, during the period of the transactions challenged in the complaint, of four hundred shares of the capital stock of the defendant Warner Bros. Pictures, Inc., and that he is suing derivatively on behalf of and for the benefit of said defendant Warner Bros. Pictures, Inc., and the stockholders thereof; that by the prayer of the complaint a trust is

sought to be impressed on the capital stock and assets of United States Pictures, Inc., in favor of Warner Bros. Pictures, Inc., the agreement between said Warner Bros. Pictures, Inc. and United States Pictures, Inc. referred to in the complaint is sought to be cancelled and terminated and that the defendants Milton Sperling, Harry M. Warner, Jack L. Warner and United States Pictures, Inc. be required to account to Warner Bros. Pictures, Inc., for all losses and damages suffered by it and its subsidiaries and all profits and benefits received by said defendants and that said defendants make restitution accordingly. That the claim set forth in the first cause of action of the complaint, and relief sought, are for and on behalf of the defendant Warner Bros. Pictures, Inc., and that the said Warner Bros. Pictures, Inc. is the real party in interest in said cause of action.

"IV. That the Board of Directors of Warner Bros. Pictures, Inc. is composed of eleven men of whom the defendants Harry M. Warner, Jack L. Warner and their brother, Albert Warner, are but three; that the contract in controversy was made and entered into in good faith and without fraud, and said contract was intended by the directors to be of financial benefit to Warner Bros. Pictures, Inc. and its stockholders, and said contract was considered by said eleven members of the Board of Directors of Warner Bros. Pictures, Inc. to be a sound business arrangement for the best present and future interests of the corporation; that in approving and authorizing the contract, the officers and Board of Directors acted in good faith and exercised their independent business judgment. That at the time of the execution of the contract, Albert Warner, together with the defendants Harry M. Warner and Jack L. Warner, owned less than twenty percent of the outstanding shares of

stock of Warner Bros. Pictures, Inc., and that neither the corporation nor the directors or officers were shown to be at that time or at any time under the domination or control of the three brothers Warner above named. That neither the stockholders, its officers or directors were at any time involved in this action, antagonistic to the financial interests of the corporation.

"V. That it is not true either as alleged in the complaint, or otherwise, that all or a majority or any of the Board of Directors and officers of Warner Bros. Pictures, Inc. wrongfully participated in the acts in the complaint complained of, nor was said Board of Directors dominated or controlled by Harry M. Warner, Jack L. Warner, Albert Warner, Milton Sperling, or any one or more of them. It is not true that if demand had been made upon Warner Bros. Pictures, Inc., that those to whom such application would be made to institute such suit would have been disqualified from faithfully doing their duty as directors and officers of said corporation because of any matters or facts set forth in said complaint, or otherwise. That no demand was made on the directors of said Warner Bros. Pictures, Inc. to institute this action and such a demand would have been futile; nor was any demand addressed to the stockholders of said corporation. That the stockholders of said corporation were not at the time of the execution of the contract complained of or at any time or at all under the domination or control of the three brothers Warner; nor was said corporation at any time herein referred to in hands or under control, antagonistic to the financial interests of said corporation and its stockholders.

"That because of the foregoing findings of fact, Warner Bros. Pictures, Inc. should be by the Court realigned as a party plaintiff and that upon such re-

alignment it appears that a plaintiff, Warner Bros. Pictures, Inc., is a citizen of the State of Delaware, and that the defendant, United States Pictures, Inc. is a citizen of the State of Delaware.

"That the sole basis of the jurisdiction of this Court is the claim set forth in the complaint of diversity of citizenship and that in view of the realignment of the parties in accordance with these findings, such diversity does not exist."

The record has been examined and gives no occasion for a reversal upon the facts found by the trial court. Only two questions of law remain. The trial court did not attempt to decide the cause on the merits, and this Court makes no such attempt either.

The key questions are:

First. Where the complaint asserted that the two directors Warner dominated and controlled the corporation Warner Bros. and conspired to misappropriate the assets and business opportunities of the corporation and caused it to enter an utterly improvident contract with United, was the trial court empowered to go behind the allegations and, on the facts found, realign Warner Bros. as a plaintiff?

Second. Where United was a party served and appearing in the case and thus before the court, was it proper for the court to dismiss the second cause of action because United was not named in the second cause of action as a party against whom relief was sought therein?

The first question is answered by another. This question is whether Doctor v. Harrington, 196 U. S. 579, is indistinguishable from the case at bar. If so, the trial court must be reversed as to the first cause of action. In that case the complaint set up that Harrington and the individual defendant had the voting power of a majority of stock,

directed the management of the affairs of the corporation, dictated its policy and selected its directors. Without holding a hearing to determine the truth of such allegations, the trial court dismissed the bill for lack of jurisdiction. The Supreme Court of the United States reversed on the ground that, accepting the allegations of the complaint, there was no ground to realign the parties since the corporation had been used as a tool without independent volition. To like effect are Venner v. Great Northern Railway Company, 209 U. S. 24, and Central Railroad Company of New Jersey v. Mills, 113 U. S. 249. It is hardly conceivable that the court in the Harrington case enjoined the trial court, on remand after the reversal therein, to entertain the action even though it should be discovered as a matter of fact that, contrary to allegation, the corporation was not under disabling domination. Judicial power of the federal courts expires when lack of jurisdiction is uncovered at any stage of the proceedings. In the case of Cutting v. Woodward, 9 Cir., 255 Fed. 633, the court found after trial that a purported sale of assets to the president of the company had been the merest sham and that virtual control of a majority of the Board was exercised by the president. Actual fraud was thus established by the finding. Appellant cannot complain of divergence of facts found by the trial court here and a different court in a different suit. The courts of the federal system are of special and limited jurisdiction. The first inquiry in any of these tribunals must be directed to the end of discovering whether in fact the judge has the power to entertain and decide the controversy. In the inferior federal courts, this inquiry must be directed to the statutes by which Congress has authorized and empowered them to act.

The preliminary proceeding by the court was thus proper. In any event, Rule 42 (b), Federal Rules of Civil Procedure, permits the trial court to isolate any issue and try it first. No jury trial was involved, so that question does not arise. In the event that a trial had been held and the court had found that the corporation was not under domination, it would have been incumbent upon the court to dismiss upon the grounds of lack of jurisdiction. The chances are that, if a trial had been held and the evidence failed to show domination, the determination would have been upon the merits. This circumstance probably explains the lack of precedents. It appears then that the only point of appellant is that the trial court passed upon the question of its jurisdiction at the outset. Appellant would not have benefited by delay.

It must be held ever firmly in the field of view that the question is one of jurisdiction of the District Court. It has consistently been held through the whole history of the federal judiciary that jurisdiction depends upon the facts. If it be assumed that the appropriate allegations or jurisdiction appear in the pleadings and the cause has been fully tried and judgment entered, still if the facts in record do not show jurisdiction existed, the judgment must be set aside and the cause dismissed. If the case has been affirmed and the lack of such facts is found by the Supreme Court of the United States, the result must be the same.

A great many of these cases have been decided upon the allegations of the pleadings. If the appropriate allegations are made in the complaint to show the corporation under domination of the individual defendants and the corporation depends upon the same grounds and with the same lawyers as the individual defendants, it is apparent

that a prima facie case is made. But, when the trial is over, the court might well find that the corporation was never dominated, but was at all times a free and uncontrolled agency. When such facts are established uncontrovertibly, jurisdiction is at an end and the parties must be realigned.

There seems to be no ground for saying, because no precedent appears in the books for the trial of these decisive questions at the threshold, it cannot be done. Either jurisdiction subsists or it does not. There is an absolute dichotomy. If any doubt existed, the Federal Rules of Civil Procedure now confirm the right of the court to try any issue separately and in advance of others.

It would be burdensome to the court and litigants if everyone were forced to accept allegations which all knew were false as a basis for jurisdiction and proceed to a long and expensive trial of the case, only to find by this arduous process that the allegations were untrue. Allegations are extremely easy to write. The tendency to abuse of stockholders derivative actions is too well known to require comment. Once the facts are found, as here, proper realignment must be made and jurisdiction does not exist.

The dismissal of the second cause of action gives us pause. The ground of dismissal assigned by the trial court was "lack of equity."[2] This ground was apparently based upon the failure of plaintiff to join United States Pictures, Inc., as a defendant in the second cause of action although it was a defendant in the first cause of action and its name appeared in the title. The second cause of action was asserted against Harry M. Warner and Jack L. Warner, citizens of California, as directors and officers of

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[2]117 F. Supp. 781, 811.

Warner Bros. Pictures, Inc., a corporation of Delaware. Since plaintiff was a resident and citizen of New York, realignment of Warner Bros., as a plaintiff, would not have destroyed jurisdiction. The lack of equity seems to have been based upon the feeling that the cause could not have been completely disposed of without the presence of United States Pictures, Inc.[3] But the provisions of Rule 19(b) Federal Rules of Civil Procedure, may have been applicable. There it is provided that the court in its discretion may proceed in the action without joining persons "who ought to be parties if complete relief is to be accorded between those already parties." if "their joinder would deprive the court of jurisdiction of the parties before it." Now, "indispensable parties" are excluded from the provisions of this rule. The trial court did indicate that United States Pictures, Inc., was an "indispensable party."[4] However, there is an apparent confusion in this statement. It may be that the trial court considered the question of whether a claim was stated in the so-called "second cause of action" since a holding that United States Pictures, Inc., is an indispensable party may involve a ruling that this count does not state a justiciable claim against Harry M. Warner and Jack L. Warner. But the trial court seemed to feel there were jurisdictional implications.[5] No

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[3]United is referred to variously by the trial court as "not * * * subject to 'necessary joinder' by the terms of Rule 19(a)"; as "clearly a person who 'ought to be' a party within the meaning of Rule 19(b)"; and as "one of the 'parties so indispensable that a court of equity will not proceed to final decision without them'." 117 F. Supp. 781, 810.

[4]117 F. Supp. 781, 810. See Note 3 above.

[5]"So in the case at bar, although diversity jurisdiction may exist as to the second cause of action, the question still remains whether the second cause of action is within the equity jurisdiction of this court." 117 F. Supp. 781, 809-810. See State of Washington vs. United States, 9 Cir., 87 F. 2d 421, 427.

opportunity to amend was given, which normally follows a ruling on motion to dismiss.

This Court does not rule upon the question of whether a claim could be stated against the directors for alleged breach of trust to their own profit, absent United States Pictures, Inc., if Warner Bros. were realigned.[6] It is doubtful whether the trial court ruled on the point, and we do not reach it.

We hold the trial court should have determined the legal sufficiency of the "second cause of action" against the Warners before proceeding to a determination of the status of the parties and the necessity of joining United States Pictures, Inc., and thus destroying jurisdiction.

Affirmed as to the first cause of action. Reversed and remanded as to the second.

(Endorsed:) Opinion. Filed May 21, 1956.

Paul P. O'Brien, Clerk.

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[6]Cf. Western States Life Insurance Co. vs. Lockwood, 166 California 185; Reid vs. Robinson, 64 California Appeals 46.

[7]Bourdieu vs. Pacific Oil Co., 299 U. S. 65. Cf. Calcote vs. Texas Pacific Coal & Oil Company, 5 Cir., 157 F. 2d 216; United States vs. McIntire, 9 Cir., 101 F. 2d 650.

Opinion of the United States District Court.

In the District Court of Appeal of the State of California, Southern District of California, Central Division.

Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant, vs. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Appellees. Civil No. 9005-WM.

Filed Dec. 16, 1953.

MEMORANDUM OF DECISION.

MATHES, District Judge.

Edward S. Birn, "owner of 400 shares of the capital stock of defendant Warner Bros. Pictures, Inc. . . . since August 21st, 1944," commenced this action in this court on December 15, 1948, "suing derivatively on behalf of and for the benefit of defendant Warner Bros. Pictures, Inc., and the stockholders thereof."

The complaint contains three separate claims or causes of action. The third, alleging a violation of the Sherman and Clayton Acts, 15 U. S. C. A. §§ 1, 15, was dismissed without prejudice by order of court prior to trial. (Fed. Rules Civ. Proc., Rules 23(a) (1)(c), 41(a)(2)(b), 28 U. S. C. A. 83, 379 (1950).) The second cause of action is asserted against defendants Harry M. Warner and Jack L. Warner alone and is grounded upon alleged violation of "their fiduciary duties as directors" of defendant Warner Bros. Pictures, Inc.

The first cause of action is asserted against all named defendants and the allegations material here are briefly: that defendant Milton Sperling is a son-in-law of defendant Harry M. Warner; that the latter and his two

brothers, Albert Warner and defendant Jack L. Warner, "control and dominate Warner Brothers" and "actually select, dominate and control the directors and officers of Warner Bros."; that about the summer of 1945 the individual defendants Milton Sperling and Harry M. and Jack L. Warner conspired "to waste . . . and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling . . . . at the expense of Warner Bros."; that in furtherance of the objects of this conspiracy defendant United States Pictures, Inc. was organized as a Delaware corporation and since September, 1946 defendant Sperling has been the sole stockholder; that "in or about September, 1945, the defendants caused Warner Bros. and United to enter into an agreement" for the production of motion pictures by United at the studio of Warner Bros. upon terms improvident and unfair as to Warner Bros. and unwarrantedly favorable to United; that "demand upon the directors of Warner Bros. to institute this action would be futile . . ."; and that plaintiff "and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted."

The prayer is that "the defendants account to Warner Bros. . . ."; that "a trust be impressed upon the capital stock and assets of United in favor of Warner Bros."; that "the agreement between Warner Bros. and United . . . be cancelled and terminated."

Defendants Harry M. and Jack L. Warner and Warner Bros. joined in an answer denying the substantive allegations of the complaint and pleading affirmatively the bar of California's applicable statute of limitations. Defendants Sperling and United filed an answer to like effect.

The original jurisdiction of this court is invoked upon the claimed ground that "the matter in controversy exceeds the sum or value of $3,000 exclusive of interest and costs, and is between . . . citizens of different States. . . ." [28 U. S. C. §1332.]

It is true, as alleged, that plaintiff is a citizen of New York, that defendants Warner Bros. and United are "corporations incorporated under the laws of . . . Delaware," and that defendants Milton Sperling and Harry M. and Jack L. Warner are citizens of California.

Since this court possesses only such jurisdiction as has been conferred by statute, [U. S. Const. Art. III; Lockerty, v. Phillips, 319 U. S. 182, 187 (1943) and "lack of federal jurisdiction cannot be waived or overcome by an agreement of the parties" [Mitchell v. Maurer, 293 U. S. 237, 244 (1934)], jurisdiction is the threshold issue in every case brought here. [Rhode Island v. Massachusetts, 12 Pet. (37 U. S.) 657, 720 (1838); Brown v. Keene, 8 Pet. (33 U. S.) 112 (1834); Capron v. Van Noorden, 2 Cranch (6 U. S.) 126 (1804).]

"This question the court is bound to ask and answer for itself, even when not otherwise suggested. . . ." [M. C. & L. M. Railway Co. v. Swan, 111 U. S. 379, 382 (1884); Clark v. Paul Gray, Inc., 306 U. S. 583, 588 (1939); St. Paul Mercury Ind. Co. v. Red Cab Co., 303 U. S. 283, 287-290 (1938); McNutt v. Gen. Motors etc. Corp., 298 U. S. 178, 184-189 (1936); Robinson v. Anderson, 121 U. S. 522 (1887); Williams v. Nottawa, 104 U. S. 209, 211 (1881); Minnis v. So. Pac. Co., 98 F. 2d 913, 915 (9th Cir. 1938), cert. denied, 306 U. S. 631 (1939).]

While jurisdictional issues in each case are properly triable to the court [North Pac. S. S. Co. v. Soley, 257 U. S. 216, 221-223 (1921); Gilbert v. David, 235 U. S. 561, 566-568 (1915); Taylor v. Hubbell, 188 F. 2d 106, 109 (9th Cir. 1951), cert. denied, 342 U. S. 818 (1951)] there is no statute or rule of court prescribing "any particular mode in which the question of . . . jurisdiction is to be brought to the attention of the court, nor how such question, when raised, shall be determined." [Wetmore v. Rymer, 169 U. S. 115, 120 (1898).]

Rule 12(h) directs "that whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action." [Fed. Rules Civ. Proc., Rule 12(h), 28 U. S. C. A. at 336.]

Rule 12(d) contemplates a hearing and determination of jurisdictional issues in advance of the trial of other issues [Fed. Rules Civ. Proc., Rule 12(d), 28 U. S. C. A. at 335; Stauffer v. Exley, 184 F. 2d 962, 967 (9th Cir. 1950); 2 Moore's Federal Practice §12.16 (2d ed. 1948).].

And the Supreme Court has declared that: "Since there is no statutory direction for procedure upon an issue of jurisdiction, the mode of its determination is left to the trial court." [Gibbs v. Buck, 307 U. S. 66, 71-72 (1939); cf. Gulbenkian v. Gulbenkian, 33 F. Supp. 19 (S. D. N. Y. 1940).]

As a general rule therefore the trial court may, in its discretion, try all issues of fact as to jurisdiction by receiving oral testimony and other evidence [Gilbert v. David, supra, 235 U. S. at 566, 568], or by receiving and weighing affidavits [KVOS, Inc. v Ass. Press, 299 U. S. 269, 277-278 (1936); Mechanical Appliance Co. v. Castle-

man, 215 U. S. 437, 440-441, 445-446 (1910); Wetmore v. Rymer, supra, 169 U. S. at 119; Fed Rules Civ. Proc., Rule 43(a)(e), 28 U. S. C. A. at 418.]

To borrow language from Land v. Dollar, 330 U. S. 731 (1947), "when a question of the District Court's jurisdiction is raised, either by a party or by the court on its own motion . . . Fed. Rules Civ. Proc., 12(b), the court may inquire, by affidavits or otherwise, into the facts as they exist." [330 U. S. at 735, n. 4.].

Whether the question be raised by the court or by motion or plea or answer of a party [see Steigleder v. McQuesten, 198 U. S. 141 (1905); Coal Co. v. Blatchford, 11 Wall. (78 U. S.) 172, 178 (1870); Smith v. Kernochen, 7 How. (48 U. S.) 198 (1849)], the burden of proof always rests upon the party asserting existence of jurisdiction. [KVOS. Inc. v. Ass. Press, supra, 299 U. S. at 278; McNutt v. Gen. Motors etc. Corp., supra, 298 U. S. at 189-190; Seslar v. Union Local 901, 198 F. 2d 403, 407 (7th Cir. 1951), cert. denied, 341 U. S. 940 (1951); Barron & Holtzoff, 1 Federal Practice and Procedure (Rules edition), §352 (1950 ed., 1952 Supp.).] That is to say, it is incumbent upon any party who invokes the jurisdiction of a federal court to establish by a preponderance of evidence all facts "upon which the court's jurisdiction depends." [Fed. Rules Civ. Proc., 8(a), 28 U. S. C. A. at 252.]

In the case at bar oral motion was made by the defendants at pretrial hearing to dismiss the action for "lack of jurisdiction over the subject matter" [Fed. Rules Civ. Proc., Rule 12(b)(1), (d), (h), 28 U. S. C. A. at 335-336], upon the ground that requisite diversity of citizenship was lacking at the commencement of the action, in that Warner Bros., a Delaware corporation, must be

aligned as a party plaintiff for diversity purposes, thus leaving a New York citizen and a Delaware corporation as plaintiffs and three California citizens and a Delaware corporation as defendants. [See: Miss. Pub. Corp. v. Murphree, 326 U. S. 438, 441, n. 2 (1946); St. Louis etc. Ry. Co. v. James, 161 U. S. 545, 562-563 (1896); Doctor v. Harrington, 196 U. S. 579, 586-587 (1905); Louisville etc. R. Co. v. Letson, 2 How. (43 U. S.) 497, 554-558 (1844); Marshall v. B. & O. R. R. Co., 16 How. (57 U. S. 314 325-329 (1853).]

A trial of the jurisdictional and the statute-of-limitations issues, in advance of trial of the other issues in the case, was ordered.

As the parties were aligned by plaintiff, complete diversity of citizenship appeared from the face of the complaint upon commencement of the action. [Pacific R. Co. v. Ketchum, 101 U. S. 289, 298 (1879).] Prior to trial the original plaintiff, New York citizen Edward S. Birn, died and the Probate Court of California appointed Charles B. Smith as Special Administrator of the estate. [Cal. Prob. Code §§460, 463.] Smith, a citizen of California, was thereupon substituted as party plaintiff. [Fed. Rules Civ. Proc., Rule 25(a), 28 U. S. C. A. at 156.]

Where diversity jurisdiction exists at the commencement of an action, a subsequent change of citizenship of one of the parties does not oust it. [Wichita R. R. v. Pub. Util. Comm., 260 U. S. 48, 53-54 (1922); Louisville etc. Ry. Co. v. Louisville Trust Co., 174 U. S. 552, 566 (1899); Clarke v. Mathewson, 12 Pet. (37 U. S.) 164, 171 (1838); Dunn v. Clarke, 8 Pet. (33 U. S.) 1, 2 (1834); Mullen v. Torrance, 9 Wheat. (22 U. S.) 537, 538 (1824).] It follows then that while the citizenship of the administrator at bar would have been a factor if he had

originally brought the action, his citizenship as substituted party plaintiff is held not to affect determination as to diversity jurisdiction. [See: Continental Ins. Co. v. Rhoads, 119 U. S. 237 (1886); Blake v. McKim, 103 U. S. 336 (1880); Amory v. Amory, 95 U. S. 186 (1877); Rice v. Houston, Admr., 13 Wall. (80 U. S.) 66 (1871); cf. Jeffcott v. Donovan, 135 F. 2d 213 (9th Cir. 1943).]

Subject to the exception that diversity jurisdiction can be acquired by dropping parties not indispensable [Dollar S. S. Lines v. Merz, 68 F. 2d 594 (9th Cir. 1934); Sechrist v. Palshook, 95 F. Supp. 746 (M.D. Pa. 1951); Fed. Rules Civ. Proc., Rule 21, 28 U. S. C. A. at 71], it is settled that as a general rule all other than mere "nominal" or "formal" parties are to be considered in determining whether there exists the diversity of citizenship required by 28 U. S. C. §1332. [See: Hamer v. N. Y. Rys. Co., 244 U. S. 266, 274 (1917); Waterman v. The Canal-Louisiana etc. Bank Co., 215 U. S. 33, 47 (1909); Geer v. Mathieson Alkali Works, 190 U. S. 428, 433 (1903); Bacon v. Rives, 106 U. S. 99, 104 (1882); Barney v. Latham, 103 U. S. 205, 214 (1880); Walden v. Skinner, 101 U. S. 577, 588-589 (1879); Horn v. Lockhart, 17 Wall. (84 U. S.) 570, 579 (1873); Wood v. Davis, 18 How. (59 U. S.) 467, 469 (1855); Wormley v. Wormley, 8 Wheat. (21 U. S.) 421, 451 (1823); Schuckman v. Rubenstein, 164 F. 2d 952 (6th Cir. 1947).]

In order to ascertain whether the Delaware corporation Warner Bros. is an indispensable party to appropriate adjudication of the stockholder's derivative suit at bar, we must look to the law of California [Erie R. Co. v. Tompkins, 304 U. S. 64 (1938)], to "the entire body of sub-

stantive law governing an identical action in the state courts." [Ruhlin v. N. Y. Life Ins. Co., 304 U. S. 202, 209 (1938); and see Cohen v. Beneficial Loan Corp., 337 U. S. 541, 555-557 (1949).]

Insofar as the first cause of action involves validity of the 1945 agreement between Warner Bros. and United, since that agreement was executed in New York, any cause of action to cancel it presumably arose under New York law. And where suit is brought on a foreign cause of action in the courts of California, substantive matters are held governed by the law of the place where the cause arose, while procedural matters are held governed by California law. [Biewend v. Biewend, 17 Cal. 2d 108, 109 P. 2d 701 (1941); accord, Restatement, Conflict of Laws §584 (1934).] Moreover, whether a matter in such a suit is substantive or procedural is a question of California law. [Klaxon Co. v. Stentor Electric Mfg. Co., 313 U. S. 487 (1941); accord, Restatement, Conflict of Laws § 584 (1934).]

The courts of California apply to the conduct of foreign corporations doing business within the state, such as Warner Bros. here, the same standard as to domestic corporations. [See: Turner v. Markham, 155 Cal. 562, 102 Pac. 272 (1909); Findley v. Garrett, 109 Cal. App. 2d 166, 240 P. 2d 421 (1952); Angelus Sec. Corp. v. Ball, 20 Cal. App. 2d 436, 67 P. 2d 158 (1937); cf. Pratt v. Odell, & Co., 49 Cal. App. 2d 550, 122 P. 2d 684 (1942); Cal. Corp. Code § 6601; Ballantine & Sterling, Calif. Corp. Laws, §410, p. 515 (1949 ed.); see, also, Rogers v. Guaranty Trust Co., 288 U. S. 123 (1933); Overfield v. Pennroad Corp., 146 F. 2d 889, 894-896 (3d Cir. 1944); Bovay v. H. M. Byllesby & Co., 27 Del. Ch. 33, 29 A. 2d 801 (1943); id. 27 Del. Ch. 381, 38 A. 2d 808 (1944).]

Speaking of a stockholder's derivative suit, the California courts have declared that: "A stockholder who institutes it sues purely as a trustee to redress corporate injuries." [Whitten v. Dabney, 171 Cal. 621, 629; 154 Pac. 312, 315 (1915).]

Also that: "As a general rule of law . . . where a stockholder of a corporation seeks to maintain an action for a wrong done to the corporation, such stockholder occupies no better or different position with relation thereto than would the corporation itself suing in its own behalf." [Reid v. Robinson, 64 Cal. App. 46, 55, 220 Pac. 676, 680 (1923).]

"The fact that a stockholder is the nominal plaintiff does not in any manner enlarge the rights and remedies of the action." [Earl v. Lofquist, 135 Cal. App. 373, 376, 27 P. 2d 416, 418 (1938).]

And in cases where the corporation and its board of directors are "wholly under the domination of those who committed the original fraud, the corporation is deemed to be in the same position as an incompetent person or a minor without legal capacity . . . ." [Beal v. Smith. 46 Cal. App. 271, 279, 189 Pac. 341, 345 (1920). See, also: Sutter v. Gen. Pet. Corp., 28 Cal. 2d 525, 530, 170 P. 2d 898, 900 (1946); Klopstock v. Superior Court, 17 Cal. 2d 13, 17, 108 P. 2d 906, 908 (1941); Turner v. Markham, supra, 155 Cal. at 569, 570, 102 Pac. at 275.]

The substantive law of New York as to the nature and ownership of the cause of action involved in a stockholder's derivative suit is in all material respects the same as that of California. [See: Clark v. Greenberg, 296 N. Y. 146, 71 N. E. 2d 443 (1947); Isaac v. Marcus, 258 N. Y. 257, 179 N. E. 487 (1932); Flynn v. Brooklyn City R. Co.,

158 N. Y. 493, 53 N. E. 520 (1899); Alexander v. Donohoe, 143 N. Y. 203, 38 N. E. 263 (1894); Earl v. Brewer, 248 App. Div. 314, 289 N. Y. S. 150 (1936), aff'd 273 N. Y. 669, 8 N. E. 2d 339 (1937).]

In the courts of California, then, and New York as well, the plaintiff-stockholder's corporation is the real party in interest and an indispensable party to appropriate adjudication of the action.

This view accords with that expressed in the decisions of the United States Supreme Court. [See: Cohen v. Beneficial Loan Corp., supra, 337 U. S. at 548; Koster v. Lumbermans Mutual Co., 330 U. S. 518, (1947); Meyer v. Fleming, 327 U. S. 161 (1946); Davenport v. Dows, 18 Wall. (85 U. S.) 626 (1873); also: Lee v. Lehigh Valley Coal Co., 267 U. S. 542 (1925); Hamer v. N. Y. Rys. Co., supra, 244 U. S. at 274; Dickerman v. Northern Trust Co., 176 U. S. 181, 188 (1900); Blacklock v. Small, 127 U. S. 96 (1888); Pacific R. R. v. Ketchum, supra, 101 U. S. at 298-299; Memphis v. Dean, 8 Wall. (75 U. S.) 64, 73-74 (1868).]

As Mr. Justice Jackson wrote in Koster v. Lumbermens Mutual Co., supra: "The cause of action which such a plaintiff brings before the court is not his own but the corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself." [330 U. S. at 522-523.]

Moreover, as Mr. Justice Douglas said in Meyer v. Fleming, supra: "The corporation is a necessary party. * * * Hence, it is joined as a defendant. But it is only nominally a defendant, since any judgment obtained against the real defendant runs in its favor.* * * *

The fact that the corporation is nominally a defendant should not lead to any different result. That gives the suit only a difference in form, not a difference in substance." [327 U. S. at 167-168.]

In California, as under our rules [Fed. Rules Civ. Proc., Rules 17, 19(a), 28 U. S. C. A. at 12, 36], every action must normally be prosecuted in the name of the real party in interest. [Cal. Code Civ. Proc. §367], "but if the consent of anyone who should have been joined as plaintiff cannot be obtained, he may be made a defendant . . ." [Id. §382.]

With respect to "an executor, administrator, guardian, trustee of an express trust", Rule 17 states that each "may sue in his own name without joining with him the party for whose benefit the action is brought . . . ." [Fed. Rules Civ. Proc., Rule 17(a), 28 U. S. C. A. at 12.] In such cases, since the person for whose benefit the action is prosecuted need not be joined, the citizenship of the representative who sues, and not that of the beneficiary of the suit, is considered in determining whether diversity jurisdiction exists. [See: Hamer v. N. Y. Rys. Co., supra, 244 U. S. at 274; Hess v. Reynolds, 113 U. S. 73, 76 (1885); Knapp v. Railroad Co., 20 Wall. (87 U. S.) 117 (1873); Rice v. Houston, Admr., supra, 13 Wall. at 67; Coal Co. v. Blatchford, supra, 11 Wall. (78 U. S.) at 175; Childress v. Emory, 8 Wheat. (21 U. S.) 642, 668-669 (1823); cf. In Re Moore, 209 U. S. 490 (1908); Mex. Cent. Ry. Co. v. Eckman, 187 U. S. 429 (1903); Anglo-California Nat. Bank v. Lazard, 106 F. 2d 693, 699-700 (9th Cir. 1939), cert. denied, 308 U. S. 624 (1940); Mayer v. Cohrs, 188 Fed. 443 (C. C. E. D. Wash. 1911).]

The stockholder's derivative suit is a historical exception to the rule that the action be prosecuted in the name of the real party in interest. The exception permits the stockholder to sue in his own name, but he is required to join the corporation as a party. In Davenport v. Dows, supra, 18 Wall. 626, the Court pointed out the reasons in some detail, saying: "It would be wrong, in case the shareholder were unsuccessful, to allow the corporation to renew the litigation in another suit, involving precisely the same subject matter. To avoid such a result, a court of equity will not take cognizance of a bill brought to settle a question in which the corporation is the essential party in interest, unless it is made a party to the litigation." [18 Wall. at 627; see also: Helm v. Zarecor, 222 U. S. 32, 36-38 (1911); Steele v. Culver, 211 U. S. 26, 29 (1908); Porter v. Sabi 149 U. S. 473, 478 (1893); Dewing v. Perdicaries, 96 U. S. 193, 197-198 (1877); cf. Lee v. Lehigh Valley Coal Co., supra, 267 U. S. at 543; Hamer v. N. Y. Rys. Co., supra, 244 U. S. at 272-275; American Bible Society v. Price, 110 U. S. 61 (1884).]

Clearly then, the corporation for whose benefit a stockholder's derivative suit is brought is an indispensable party to appropriate adjudication of the "matter in controversy," and as such is one of the parties whose citizenship is to be considered and counted in determining whether diversity jurisdiction exists [Dawson v. Columbia Trust Co., 197 U. S. 178, 180-181 (1905); Shields v. Barrow, 17 How. (58 U. S.) 129, 139, 145 (1854)]—in determining whether "the matter in controversy * * * is between * * * citizens of different states" [28 U. S. C. §1332], "all of whom on one side of the controversy are citizens of different states from all parties on the other side." [Indianapolis v. Chase National Bank,

314 U. S. 62, 69 (1941); Strawbridge v. Curtiss, 3 Cranch (7 U. S.) 267 (1806).]

It is "the duty of the court in determining whether there was the requisite diversity of citizenship to arrange the parties with respect to the actual controversy, looking beyond the formal arrangement made by the bill." [Helm v. Zarecor, supra, 222 U. S. at 36; and see; Lee v. Lehigh Valley Coal Co., supra, 267 U. S. at 543; Hamer v. N. Y. Rys. Co., supra, 244 U. S. at 274; Steele v. Culver, supra, 211 U. S. at 29; Dawson v. Columbia Trust Co., supra, 197 U. S. at 181; Blacklock v. Small, supra, 127 U. S. at 104; Harter v. Kernochan, 103 U. S. 562, 566 (1880).]

In the words of Mr. Chief Justice Waite, a federal court should, "for the purpose of jurisdiction * * * ascertain the real matter in dispute, and arrange the parties on one side or the other of that dispute" [Pacific R. R. v. Ketchum, supra, 101 U. S. at 298]; "and the pleadings may be put aside, and the parties placed on different sides of the matter in dispute according to the facts." [Removal Cases, 100 U. S. 457, 469 (1879).]

As Mr. Justice Frankfurter observed in Indianapolis v. Chase National Bank, supra: "These familiar doctrines governing the alignment of parties for purposes of determining diversity of citizenship have consistently guided the * * * federal courts * * *" [314 U. S. at 70.]

One of the first tests to be applied in determining whether a defendant should be aligned with the plaintiff is the prayer for relief. [Dawson v. Columbia Trust Co., supra, 197 U. S. at 180-181; Mahon v. Guaranty Trust etc. Co., 239 Fed. 266, 269 (7th Cir. 1917).] In Steele v. Culver, supra, Mr. Justice Holmes declared for an unani-

mous Court that: "The omission of any prayer for relief against * * * [a corporate defendant] simply shows that properly it is to be treated as a plaintiff in this case." [211 U. S. at 29. Accord: Lee v. Lehigh Valley Coal Co., supra, 267 U. S. 542; Hamer v. N. Y. Rys. Co., supra, 244 U. S. at 272-274.] As stated before, the complaint at bar discloses not the slightest pretence of asking relief against Warner Bros. as a party defendant.

But plaintiff contends that a stockholder's derivative action stands as an exception to all rules governing alignment of parties. First cited in support of this contention is Doctor v. Harrington, supra, 196 U. S. 579, which, says plaintiff, holds that the stockholder's corporation, by refusing to sue and disputing or refuting the claim made on its behalf by the suing stockholder, in legal effect aligns itself on the defendants' side of "the matter in controversy." In other words, plaintiff contends in effect that refusal of the corporation to join with the suing stockholder operates as a matter of law, under the rule of Doctor v. Harrington, to align the corporation with the defense for diversity jurisdiction purposes.

The inquiry is thus turned to consider whether the Court has laid down a fixed rule to govern alignment in stockholder's derivative actions, or whether alignment in such cases, as in other cases, turns upon the facts as disclosed by the pleadings and, where available, the evidence.

In Doctor v. Harrington the trial court dismissed "on the ground that it had no jurisdiction of the facts alleged, and certified to the [Supreme] Court the question of jurisdiction." [196 U. S. at 579.] It was alleged in the bill of complaint that the complainant stockholders were citizens of New Jersey; that the corporate defendant; on whose behalf they sued to set aside a judgment obtained

against it by defendants Harrington, was a New York corporation and hence a citizen of New York as were defendants Harrington. [Id. at 580.]

It was also alleged that "The board of directors of said corporation is under the absolute control and domination of the defendant John Harrington * * * [who], by reason of having possession of a majority of the capital stock * * * likewise controls the action of the stockholders." [Id. at 582.]

Reversing the decree dismissing the bill for lack of jurisdiction over the subject matter, the Court said: "The ninety-fourth rule in equity contemplates that there may be, and provides for, a suit by a stockholder in a corporation founded on rights which may properly be asserted by the corporation. And the decisions of this court establish that such a suit, when between citizens of different States, involves a controversy cognizable in a Circuit Court of the United States. The ultimate interest of the corporation made defendant may be the same as that of the stockholder made plaintiff, but the corporation may be under a control antagonistic to him, and made to act in a way detrimental to his rights. In other words, his interests, and the interests of the corporation, may be made subservient to some illegal purpose. * * *

"In Detroit v. Dean, 106 U. S. 537 * * * this court ordered the bill dismissed, not because Dean and the corporation had identical interests, but because the refusal of the directors of the corporation to sue was collusive * * * Hawes v. Oakland, 104 U. S. 450, was cited, where a like right was decided to exist. See also Dodge v. Woolsey, 18 How. 331; Davenport v. Dows, 18 Wall. 626; Memphis v. Dean, 8 Wall. 64; Greenwood v.

Freight Company, 105 U. S. 13; Quincy v. Steel, 120 U. S. 241. It was said in Dodge v. Woolsey, that the refusal of the directors to sue caused them and Woolsey, who was a stockholder in a corporation of which they were directors, 'to occupy antagonistic grounds in respect to the controversy, which their refusal to sue forced him to take in defense of his rights.' Dodge v. Woolsey was modified by Hawes v. Oakland, as to what circumstances would justify a suit by a stockholder if the directors refuse to sue. * * *

"The case at bar is brought within the doctrine of those cases by the allegations of the bill." [196 U. S. at 587-588.]

Thus the Court, applying "the ninety-fourth rule in equity" as a fededal rule of substantive law [see: Swift v. Tyson, 16 Pet. (41 U. S.) 1 (1842); Venner v. Great Northern Ry., 209 U. S. 24, 33, 35 (1908)], held that the facts alleged were sufficient to invoke both the diversity and the equity jurisdiction of the Federal court. [See: Mathews v. Rogers, 284 U. S. 521, 524 (1932); Twist v. Prairie Oil Co., 274 U. S. 684, 689-692 (1927); Venner v. Great Northern Ry., supra, 209 U. S. at 34-35.] That is to say, the court took as true the facts alleged in the bill of complaint, and in effect held that the complaining stockholders not only met the requirements of Equity Rule 94, but further showed that the corporation was "under a control antagonistic" to its own financial interests and should not, because of such incapacity, be aligned with the plaintiffs in determining whether diversity jurisdiction existed.

In the earlier case of Hawes v. Oakland, 104 U. S. 450 (1881), the complaining stockholder of Contra Costa Water-Works Company, a California corporation, was

a citizen of New York. The named defendants, including the city of Oakland, the Water-Works corporation and its directors, all were citizens of California.

The bill of complaint alleged that the corporation had refused to cease furnishing the city of Oakland a free supply of water under disputed provisions of a contract between the Water-Works Company and the city. "To this bill the Water-Works Company and the directors failed to make answer; and the city of Oakland filed a demurrer, which was sustained by the court and the bill dismissed." [Id. 104 U. S. at 451.]

Upon sustaining the city's demurrer and dismissing the bill of complaint on the merits, Judge Sawyer of the Circuit [trial] Court did not refer to jurisdiction or alignment of parties. [See Hawes v. Contra Costa Water Co., 11 Fed. Cas. 862, No. 6,235 (C. C. S. D. Cal. 1878).] The fact that the Removal Cases, supra, 100 U. S. 457, were not decided until 1879, a year later, may account for Judge Sawyer's failure to realign the Water-Works Company with the complainant and dismiss the bill for lack of jurisdiction over the subject matter.

Some three years following his decision of the Hawes case, in a stockholder's derivative suit brought by Danmeyer, an alien, against Consolidated Virginia Mining Company, a California corporation, and California citizens Coleman, Flood, Fair, Machay, et al., Judge Sawyer, after citing the Removal Cases, wrote: "The complainant Danmeyer's interest as a stockholder is only secondary and derivative, and merely incidental to that of the corporation. Transferring the corporation from the side of the defendant to that of the complainant, who is simply using the corporation and litigating in his own name, and actually in behalf of the corporation and for its own benefit, as

is suggested in the Removal Cases, should be done for the purpose of determining the question of jurisdiction, and we have an alien and a California corporation on one side, and several California corporations and citizens on the other. Does not this oust the jurisdiction?" Danmeyer v. Coleman, 11 Fed. 97, 103 (C. C. D. Cal. 1882).]

Whatever may have been the reasons for Judge Sawyer's omission to dismiss the Hawes case for want of jurisdiction, still other reasons served Mr. Justice Miller, speaking for the Court upon appeal from Judge Sawyer's decree dismissing the bill on the merits, to affirm the dismissal, not upon the merits, but upon the ground that the bill showed upon its face a want of equity.

Four years previous to his opinion in Hawes v. Oakland, Mr. Justice Miller, sitting as Circuit Justice in the Circuit Court of the District of Colorado, heard a motion to remand to the state court a stockholder's derivative suit, and upon denying the motion wrote: "The suit in this case is brought, as the parties concede, and as the petition shows, by the commissioners of the county of Arapahoe, who are citizens of the State of Colorado, against the Denver Pacific Railway and Telegraph Company, which is also a citizen of Colorado, and against two gentlemen, Mr. Sayre and Mr. Moffat, who are citizens of Colorado, and against seven or eight other persons, who are citizens of other states than Colorado. The case has been removed to this court upon a petition setting forth substantially these facts, and it is now asked to be remanded because the requisite essentials, as prescribed by the act of congress conferring jurisdiction upon this court, are not found in this case. The objection is that the Denver Pacific Railway and Telegraph Company, Sayre and Moffat, are citizens of the same state with the complainants in this

action. * * * It is further alleged, in support of the objection to the jurisdiction of this court in this case, that the Denver Pacific Railway Company, and Sayre and Moffat, each of them, are necessary adverse parties to the complainants in this suit. The objection, if well taken, will require the suit to be remanded.

"The reply is that the Denver Pacific Company, and Sayre and Moffat, are nominal parties, against whom no relief is sought, and against whom no decree can be rendered; that the bill is clear and specific on that point; consequently the right which belongs to the other parties to remove the case is not and cannot be defeated by the joinder in the petition of other defendants, citizens of the same state with the complainants, against whom no relief is prayed. As regards Sayre and Moffat, the case seems very clear. A careful reading of the bill shows that no relief can be had against them. * * *"

Confronting the problem of alignment for jurisdictional purposes, Mr. Justice Miller continued: "The case then rests upon the question of whether the fact that the Denver Pacific Railway Company is a party defendant, and is a citizen of the same state of the party plaintiff, ousts the jurisdiction of this court or defeats the right of removal of the other parties who are citizens of other states. That question does not rest upon the same principle as the case of Messrs. Sayre and Moffat. The Denver Pacific Railway Company is a necessary party to this suit; it is one without which the suit cannot proceed. The main object of this suit * * * is to obtain an accounting * * * . The relief * * * asked is a decree in favor of the Denver Railway Company for the amount found due upon that accounting. The Denver Pacific Railway Company is a necessary party to that accounting.

A party cannot be required to go to all the trouble of accounting and having a decree, when that accounting and decree will not be a valid defense against the principal party having the right to call such party to account. * * * This shows very clearly that the Denver Pacific Railway Company is not a mere nominal party, but is an indispensable party. But, as already stated, the main relief sought in this case will be, if the suit is successful, a decree in favor of the Denver Pacific Railway Company for the amount found due from the other defendants in this case. That is an important and significant feature of the transaction. * * * [I]t is very clear that the interest of the Denver Pacific Railway Company is the interest of the plaintiffs; that their interest is identical—that the board of county commissioners are using the name of the Denver Pacific Company to carry on this suit solely for the benefit of that company. * * * The complainants recognize this themselves, for in their prayer for relief they say expressly what they pray for is a decree in favor of the Denver Pacific Railway Company against the Kansas Pacific Railway Company and the other defendants. Now, the controversy in this case is one in which the commissioners of Arapahoe county and the Denver Pacific Raliway Company are on one side, citizens of the state of Colorado, against all the other defendants. * * *

"The best judgment I am able to give is that this is a controversy between citizens of the state of Colorado on one side, and citizens of other states on the other side, and is properly subject to removal." [Arapahoe County v. Kansas City Ry Co., et al., 1 Fed. Cas. 1080, 1081-1083, No. 502 (C. C. D. Colo. 1877).]

It is interesting that Mr. Justice Miller wrote this opinion in Arapahoe County two years before the Removal

Cases were decided. Since both Arapahoe, 1 Fed. Cas. 1080, and the Removal Cases, 100 U. S. 457, were decided under the Act of March 3, 1875 [18 Stat. 470], it seems safe to conclude that the former served as a forerunner to the latter, in which the Court declared for the first time that: "Under the new law the mere form of the pleadings may be put aside, and the parties placed on different sides of the matter in dispute according to the facts." [100 U. S. at 469.]

Two years later, when Mr. Justice Miller came to write the opinion in Hawes v. Oakland, he omitted to cite or mention the realignment rule of either Arapahoe or the Removal Cases and does not indeed appear to have considered dismissal for lack of jurisdiction over the subject matter rather than for want of equity, notwithstanding reference in the opinion to the Act of March 3, 1875. [18 Stat. 470.] Rather, he referred back to and distinguished Dodge v. Woolsey, 18 How. (59 U. S.) 331 (1855), where both diversity and equity jurisdiction were sustained in a stockholder's derivative suit brought by Woolsey, a Connecticut stockholder of an Ohio banking corporation, against Dodge, an Ohio tax collector, "the directors of the bank, and the bank itself, defendants." [Id. at 336] "To this bill the defendant, George C. Dodge, filed an answer. The other defendants did not answer. He admits the material allegations of the bill, except the allegation that the tax law * * * is unconstitutional * * *." [Id. at 339.]

It is true, as Mr. Justice McKenna pointed out in Doctor v. Harrington, supra, 196 U. S. 579, that: "It was said in Dodge v. Woolsey, that the refusal of the directors to sue caused them and Woolsey, who was a stockholder in a corporation of which they were directors, 'to occupy an-

tagonistic grounds in respect to the controversy, which their refusal to sue forced him to take in defense of his rights.'" [196 U. S. at 588.]

The quoted statement from Dodge v. Woolsey was made by Mr. Justice Wayne in disposing of an "imputation of contrivance" between Woolsey and the directors of the bank to give the federal court jurisdiction "on account of their residence and citizenship being in different states." [18 How. at 345-346.]

In comparing Hawes v. Oakland and Dodge v. Woolsey, it is of assistance to keep in mind that the latter was decided "under the old law," and that, as stated in the Removal Cases: "Under the old law the pleadings only were looked at, and the rights of the parties in respect to a removal were determined solely according to the position they occupied as plaintiffs or defendants in the suit." [100 U. S. at 469.]

As authority for the statement last above quoted, the Court in the Removal Cases cites Coal Company v. Blatchford, supra, where Mr. Justice Field observed that "In Osborn v. The Bank of the United States, [9 Wheat. (22 U. S.) 738, 857 (1824)], the Chief Justice laid it down as a universal rule that, in controversies between citizens of different States, the jurisdiction of the Federal courts depended not upon the relative situation of the parties concerned in interest, but upon the relative situation of the parties named in the record." [11 Wall. at 175.]

Thus at the time of Dodge v. Woolsey the court had no power to consider realignment of the parties—"the pleadings only were looked at." [Removal Cases, supra, 100 U. S. at 469.] But such power did exist at the time Hawes v. Oakland was decided, and it is clear from Arap-

hoe and the Removal Cases that the Court was then mindful of realignment."

The tenor of the opinion in Hawes v. Oakland indicates that the Court deliberately chose that case as the springboard for a new rule of substantive law [Swift v. Tyson, supra, 16 Pet. 1] to curb the then prevalent evils of collusive maintenance of derivative suits by stockholders in federal courts. [104 U.S. at 459-462; see 18 Stat. 470, 472 (1875); cf. 28 U. S. C. §1359.]

So instead of realigning the parties and dismissing for lack of jurisdiction over the subject matter, the Court affirmed dismissal of the bill, not on the merits, but for want of equity, "because the appellant shows no standing in a court of equity—no right in himself to prosecute the suit." [104 U.S. at 462; see Venner v. Great Northern Ry. Co., supra, 209 U.S. at 34; cf. Bourdieu v. Pacific Oil Co., 299 U.S. 65, 70-71 (1936); Anti-Fascist Comm. v. McGrath, 341 U.S. 123, 150-157 (concurring opinion, 1951).]

At the same October Term, 1881 Mr. Justice Miller, in an opinion, Huntington v. Palmer, 104 U.S. 482 (1881), affirming a decree dismissing for want of equity a stockholder's derivative suit similar to Dodge v. Woolsey, supra 18 How. 331, said: "There is here no formal written appeal to the board * * * and there is nothing to repel the reasonable presumption that parties were improperly and collusively made in order to invoke the jurisdiction of the Federal court." [104 U.S. at 484.]

Later in the same term, Mr. Justice Miller wrote the opinion in Greenwood v. Freight Co., 105 U.S. 13 (1881), in which the Court, without discussing possible realignment of the parties or any jurisdictional issue, held that

the stockholder's bill of complaint met the substantive requirements specified in Hawes v. Oakland, supra 104 U.S. at 460-461, but affirmed the trial court's decree sustaining a demurrer and dismissing the bill for want of equity. [105 U.S. at 16, 24. See, seriatim: Detroit v. Dean, 106 U.S. 537 (1882); Central R. Co. of New Jersey v. Mills, 113 U.S. 249 (1885); Mills v. Central R. Co. of New Jersey, 20 Fed. 449, 451 (C.C.D.N.J. 1884); East Tenn. etc. Railroad v. Grayson, 119 U.S. 240, 243 (1886); cf. Smith v. McKay, 161 U.S. 355, 357 (1896); In Re Lehigh Min. & Mfg. Co., 156 U.S. 322, 327 (1895).]

Of next importance to the problem at bar is Quincy v. Steel, 120 U.S. 241 (1887), which was a stockholder's derivative suit brought in the Southern District of Illinois by a citizen of Alabama against the city of Quincy and the Quincy Gas Light and Coke Co., an Illinois corporation. A demurrer interposed by the city of Quincy was overruled, "the city refused to plead further, and decree was thereupon rendered against it." [120 U.S. at 243.] Upon appeal by the city the decree was reversed and the case remanded with instructions to sustain the demurrer and dismiss the bill on the merits.

Speaking again for the Court, Mr. Justice Miller said: "Prior to 1875 cases had come into the courts of the United States, especially into the Circuit Courts, where citizenship had been simulated, and parties improperly made or joined either as plaintiffs or defendants, for the purpose of creating a case cognizable in the Circuit Courts originally, or removable thereto from the state courts; and as it very frequently occurred that both plaintiffs and defendants were willing to seek that court in preference to the state courts, it had been found very

difficult to prevent these improper cases from being tried in those courts. In the act of March 3, 1875 [18 Stat. 470, 472], an attempt was made to correct this evil, and by the fifth section of that act it was declared 'that if, in any suit * * * it shall appear to the satisfaction of said Circuit Court, at any time after such suit has been brought or removed thereto, that such suit does not really and substantially involve a dispute or controversy properly within the jurisdiction of said Circuit Court, or that the parties to said suit have been improperly or collusively made or joined, either as plaintiffs or defendants, for the purpose of creating a case cognizable or removable under this act, the said Circuit Court shall proceed no further therein, but shall dismiss the suit or remand it to the court from whence it was removed, as justice may require.'

"In the cases of Hawes v. Oakland, 104 U.S. 450, and Huntington v. Palmer, 104 U.S. 482," Mr. Justice Miller continued, "the question of the growth of the form of invoking Federal jurisdiction, where it does not otherwise exist, by the attempt of a corporation which cannot sue in the Federal court to bring its grievance into that court by a suit in the name of one of its stockholders who has the requisite citizenship, was very much considered. In order to give effect to the principles there laid down this court at that term adopted Rule 94 of the Rules of Practice for Courts of Equity of the United States, which is as follows:

"'Every bill brought by one or more stockholders in a corporation, against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the

time of the transaction of which he complains, or that his share had devolved on him since, by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action.' 104 U.S. ix-x.

"The bill in the present case, although verified by oath, is far from complying with the letter or the spirit of this rule." [120 U.S. at 244-246.]

The 94th Equity Rule, so conceived, was later embodied in Equity Rule 27 and is now incorporated in Rule 23(b) of the Federal Rules of Civil Procedure. [See Notes of Advisory Committee foll. Rule 23, 28 U. S. C. A. at 83, 85-87.] Since it was not until 1938 that Erie R. R. Co. v. Tompkins, supra, 304 U.S. 64, overruled Swift v. Tyson, supra, 16 Pet. 1, Equity Rule 94 and successor Equity Rule 27 are to be considered as embodying both substantive and adjective law. [See: Hawes v. Oakland, supra, 104 U.S. at 459-461; Quincy v. Steel, supra, 120 U.S. at 244-248; Notes of Advisory Committee foll. Rule 23, 28 U. S. C. A. at 85-86.]

Thus the Act of March 3, 1875 [Stat. 470, 472] in effect foreclosed the equity jurisdiction of the Federal courts to every stockholder's derivative suit in which the complaining stockholder failed to establish lack of collusion. Consequently, whenever the allegations of the stockholder's bill of complaint were found insufficient to negative collusion under Equity Rule 94, or successor Rule 27—insufficient to show "standing in a court of

Equity * * * right in himself to prosecute the suit" [Hawes v. Oakland, supra, 104 U.S. at 462,]—the suit was dismissed for want of equity, and it was never considered necessary to raise the question of proper alignment of parties, since the allegations of the bill were always taken as true upon the demurrer for want of equity. [See, e.g.: Chicago v. Mills, 204 U.S. 321 (1907); Ill. Central R. Co. v. Adams, 180 U.S. 28, 38 (1901); Lehigh Mining & Mfg. Co. v. Kelly, 160 U.S. 327 (1895); cf. Niles-Bement-Pond Co. v. Iron Moulders Union, 254 U.S. 77, 81-82 (1920); Helm v. Zarecor, supra, 222 U.S. at 35.]

Venner v. Great Northern Ry., supra, 209 U.S. 24, explains this practice. There, in the language of Mr. Justice Moody: "The plaintiff * * *, a citizen of New York, brought * * * suit in equity in the Supreme Court of New York against the defendant railroad, a citizen of Minnesota, and the other defendant, its president, also a citizen of Minnesota. The complaint set forth in substance * * *: 'The plaintiff was a stockholder in the defendant railroad at the time of the beginning of the suit in 1906. * * * The defendant James J. Hill was a director and the president of the other defendant, the Great Northern Railway Company, and that railroad and its board of directors were under his absolute control. While holding these offices and exercising this control, in 1900 and 1901, Hill purchased, or caused to be purchased * * * stock of the Chicago, Burlington and Quincy Railroad Company of the par value of $25,000,000. * * * with the design of selling the stock at a higher price to the company of which he was * * * president. Subsequently, in 1901, while still holding his offices in the Great Northern Rail-

way and exercising the same control over that corporation, he sold to it a large amount of the stock * * * and made an unlawful profit of $10,000,000 on the transaction. * * * The prayer was that Hill should account for his profit and pay it to the Great Northern Railway Company with interest, and for general relief. On the defendants' petition the case was removed to the United States Circuit Court for the Southern District of New York, on the ground of diversity of citizenship. * * * The complaint did not conform to the requirements of Equity Rule 94, relating to suits of this nature. * * * The defendants then demurred separately to the bill. * * * Thereafter the plaintiff moved to remand the cause to the state court. * * * This motion was denied. The demurrer was sustained and the bill dismissed [for want of equity]. * * * The case comes here on direct appeal rom the Circuit Court on the question of jurisdiction alone, certified. * * *"

The opinion by Mr. Justice Moody proceeds: "First, was there a controversy between citizens of different States? * * * Let it be assumed for the purposes of this decision that the court may disregard the arrangement of parties made by the pleader, and align them upon the side where their interest in and attitude to the controversy really places them, and then may determine the jurisdictional question in view of this alignment. Removal Cases, 100 U.S. 457. * * * If this rule should be applied it would leave the parties here where the pleader has arranged them. It would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail. But that is not enough. Both defendants unite, as sufficiently appears by the petition and other proceedings, in resisting the plaintiff's claim of

illegality and fraud. They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant. * * * The case of Doctor v. Harrington is precisely in point on this branch of the case, and is conclusive. * * *"

Turning to Equity Rule 94 and the cases which gave rise to it, the opinion continues: "Second. Did the Circuit Court have jurisdiction of the subject matter of the litigation? It has already been shown that the plaintiff in his petition did not bring this case within the terms of Equity Rule 94. * * * It may be noted that the plaintiff in Doctor v. Harrington, supra, complied with the requirements of the rule. It is argued that a compliance with that rule is essential to the jurisdiction, and that a controversy of the general nature contemplated by the rule is beyond the jurisdiction of the Circuit Court, unless the plaintiff shows the existence of all the facts which the rule makes indispensable to his success in the suit. But this argument overlooks the purpose and nature of the rule. The rule simply expresses the principles which this court, after a review of the authorities, had declared in Hawes v. Oakland, 104 U.S. 450, to be applicable in the decision of a stockholder's suit of the kind now under consideration. Neither the rule nor the decision from which it was derived deals with the question of the jurisdiction of the courts, but only prescribes the manner in which the jurisdiction shall be exercised. If a controversy of this general nature is brought in the Circuit Court and the necessary diversity of citizenship

exists, but upon the pleadings or the proof it appears that the plaintiff has not shown a case within the decision in Hawes v. Oakland, or the rule of court declaratory of that decision, the bill should be dismissed for want of equity and not for want of jurisdiction. * * * So it was that in Hawes v. Oakland the demurrer was sustained and the bill dismissed, not for want of jurisdiction, but, in the words of the court (p. 462), 'because the appellant shows no standing in a court of equity—no right in himself to prosecute this suit.' The same order was made in Huntington v. Palmer, 104 U.S. 482, and Quincy v. Steel, 120 U.S. 241. This very question was considered by the court in Illinois Central Railroad Company v. Adams, 180 U.S. 28, where it said, p. 34: ' * * * ' At common law neither an infant, an insane person, married woman, alien enemy, nor person having no interest in the cause of action, can maintain a suit in his or her own name; but it never would be contended that the court would not have jurisdiction to inquire whether such disability in fact existed, nor that the case would be dismissed on motion for want of jurisdiction. * * * The objection that plaintiff has failed to comply with Equity Rule 94 may be raised by demurrer, but the admitted power to decide this question is also an admission that the court has jurisdiction of the case.' " [209 U.S. at 28-35. See: Simpson, Fifty Years of American Equity, 50 Harv. L. Rev. 171, 190, n. 121 (1936).]

Next cited by plaintiff at bar is Cutting v. Woodward, 255 Fed. 633 (9th Cir. 1918). There Illinois stockholders sued a California corporation and a California citizen, the appellant. The Court of Appeals said: "The court below found that during all this period the appellant

had virtual control of the majority of the board of directors, and that they were ever ready to do his bidding. These transactions constitute actual and not constructive fraud.

"The trust company raises the question of jurisdiction, asserting that the company is not an adversary party to the plaintiffs in the suit, but is the real party in interest as plaintiff, and that consequently there is no diversity of citizenship. But this is not a case in which the trust company, although made a defendant, should be realigned as a plaintiff, as in Hamer v. New York Railways, 244 U.S. 266, 274. * * * Here the attitude of the trust company is hostile to the plaintiffs. It appeared in a joint answer with the appellant, and by the same counsel, and it denied the allegations of the bill and prayed for the dismissal thereof. The cause is therefore one in which plaintiffs, citizens of Illinois, bring suit against defendants who are citizens of California. Doctor v. Harrington, 196 U.S. 579 * * * ; Venner v. Great Northern Railway, 209 U.S. 24. * * *" [255 Fed. at 635. See: Cutting v. Bryan, 30 F.2d 754, 758 (9th Cir. 1929); cf. Minnis v. Southern Pac. Co., supra, 98 F.2d at 915.]

What then is to govern alignment of parties in a stockholder's derivative suit where, as is the usual case, federal jurisdiction is invoked upon the ground of claimed diversity of citizenship?

Recalling that in Doctor v. Harrington, supra, where the stockholders' bill of complaint alleged that the "board of directors * * * is under the absolute control and domination of * * * John J. Harrington * * * [who] by reason of having possession of a majority of

the capital stock * * * likewise controls the action of the stockholders" [196 U.S. at 582], the Court, faced with answering the certified question of jurisdiction, as to "Whether * * * the complainants' bill * * * showed * * * diversity of citizenship * * *" [id. at 579], observed: "The ultimate interest of the corporation made defendant may be the same as that of the stockholder made plaintiff, but the corporation may be under a control antagonistic to him, and made to act in a way detrimental to his rights. In other words, his interests, and the interests of the corporation, may be made subservient to some illegal purpose." [Id. at 587.]

Recalling that in Venner v. Great Northern Ry., supra, where the stockholders' bill of complaint alleged that "defendant James J. Hill was * * * the president of the other defendant, the Great Northern Railway * * * and that railroad and its board of directors were under his absolute control" [209 U.S. at 29], the Court, likewise in response to the certified "question of jurisdiction" [id. at 30], found the jurisdictional facts by taking as true the allegations of the bill and the defendants' petition for removal, and declared: "Both defendants unite, as sufficiently appears by the petition and other proceedings, in resisting the plaintiff's claim of illegality and fraud. They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant. . . . The case of Doctor v. Harrington is precisely in point on this branch of the case, and is conclusive." [209 U. S. at 32.]

Recalling that in Cutting v. Woodward, *supra,* the defendant-president of the corporation was found to have "virtual control of the majority of the board of directors, . . . [who] were ever ready to do his bidding," and the Court of Appeals for this Circuit said: ". . . this is not a case in which the . . . . Company . . . should be realigned as a plaintiff. . . . Here the attitude of the . . . . Company is hostile to the plaintiffs." [255 Fed. at 635. *Cf.* Gage v. Riverside Trust Co., 156 Fed. 1002, 1007 (C. C. S. D. Cal. 1906); Opici v. Cucamonga Winery, 73 F. Supp. 603 (S. D. Cal. 1947).]

Recalling also that in Koster v. Lumbermens Mutual Co., supra, the Court commented that "jurisdiction is saved in this class of cases by a special dispensation because the corporation is in antagonistic hands. Doctor v. Harrington, 196 U. S. 579." [330 U. S. at 523.]

It would seem *ad extremum* that there can be no fixed rule for alignment of the parties in every case; that at most the binding precedents establish a test by which the court may properly determine when not to align as a party plaintiff in a stockholder's derivative suit the corporation for whose benefit the action is by definition commenced and maintains.

If the corporation has suffered actionable wrong and is "in antagonistic hands"—*i. e.* so dominated that it is incapacitated to act in keeping with its own financial interests—then a federal court should not, because of such disability, align the corporation with the plaintiff-stockholder in determining whether diversity jurisdiction exists. [Cf. Indianapolis v. Chase National Bank, supra, 314 U. S. 69-71, 74; Lee v. Lehigh Valley Coal Co., supra, 267 U. S. 542; Hamer v. New York Rys. Co., supra, 244

U. S. at 274; Helm v. Zarecor, supra, 222 U. S. 32; Venner v. Great Northern Ry., supra, 20 U. S. 32, 35; Chicago v. Mills, supra, 204 U. S. at 326; Dawson v. Columbia Trust Co., supra, 197 U. S. at 180-181; Doctor v. Harrington, supra, 196 U. S. at 587; Lehigh Min. & Mfg. Co. v. Kelly, supra, 160 U. S. 327; Groel v. United Electric Co., 132 Fed. 252, 261, 265 (C. C. D. N. J. 1904); Laughner v. Schell, 260 Fed. 396, 398 (3d Cir. 1919); Richardson v. Blue Grass Min. Co., 29 F. Supp. 658, 663 (E. D. Ky. 1939); aff'd on opinion below, 127 F. 2d 291 (6th Cir. 1942), cert. den. 317 U. S. 639 (1942).]

The quotation in Venner v. Great Northern Ry., supra, 209 U. S. at 35, from Illinois Central Railroad Co. v. Adams, supra, 180 U. S. at 34, suggests an analogy to the disability of an infant or the lack of capacity of an insane person. In Koster v. Lumbermens Mutual Co., supra, 330 U. S. 518, the Court explained that the plaintiff-stockholder sues in protection of the corporation's interest "somewhat as a 'next friend' might do for an individual" because the corporation is "disabled from protecting itself." [330 U. S. at 522-523.] State courts draw upon like analogies. [See: Reid v. Robinson, supra, 64 Cal. App. 55, 220 Pac. at 680; Clarke v. Greenberg, supra, 296 N. Y. 146, 71 N. E. 2d 443.]

Quaere whether, followed to logical conclusion, the disability concept does not require that the corporation always be considered either as a real-party-in-interest plaintiff or, if "disabled from protecting itself," a nominal defendant for *res judicata* purposes [see Davenport v. Dows, supra, 78 Wall. 626], not to be aligned on either side in determining jurisdiction. [See: In re Moore, supra, 209 U. S. 490; Mex. Cent. Ry. Co. v. Eckman, supra, 187 U. S.

429; Anglo-California Nat. Bank v. Lazard, supra, 106 F. 2d 698; Stout v. Rizney, 107 Fed. 545, 551-552 (8th Cir. 1901); Merritt v. Greenberg, 4 F. Supp. 655 (E. D. N. Y. 1933). Compare: Lavin v. Lavin, 182 F. 2d 870 (2d Cir. 1950); Groel v. United Electric Co., supra, 132 Fed. 252; Tucker v. National Linen Service Corp., 92 F. Supp. 502, 505 (N. D. Ga. 1950), aff'd, 188 F. 2d 265 (5th Cir. 1951), cert. denied, 342 U. S. 828 (1951); Tucker v. New Orleans Laundries, 90 F. Supp. 290, 292-296 (E. D. La. 1949), aff'd on opinion below, 188 F. 2d 263 (5th Cir. 1951), cert. denied, 342 U. S. 828 (1951); Cohen v. Industrial Finance Corp., 44 F. Supp. 489, 490 (S. D. N. Y. 1941); J. R. A. Corp. v. Boylan, 30 F. Supp. 393, 394, 38 Mich. L. Rev. 724 (1940), aff'd on opinion below, 109 F. 2d 1018 (2d Cir. 1940); see Venner v. Great Northern Ry., supra, 209 U. S. at 32.]

In all events, whether the corporation is under disability and so unable to act otherwise than by domination of alleged wrongdoers is a question of fact in each case. And whenever diversity of citizenship is decided upon the complaint alone, or upon the complaint and petition for removal, the facts alleged in the pleadings as to "absolute control" must of course be taken as true, as was done in Doctor v. Harrington, supra, 196 U. S. at 582, 587-588, and Venner v. Great Northern Ry., supra, 209 U. S. at 29, 32. [See: Barry v. Edmunds, 116 U. S. 550, 559 (1886); Hartog v. Memory, 116 U. S. 588, 591 (1886).]

For a corporation to be "in antagonistic hands" [Koster v. Lumbermens Mutual Co., *supra*, 330 U. S. at 523], or to have a "hostile attitude" [Cutting v. Woodward, supra, 255 Fed. at 635] such as would permit alignment on the side against its presumptive financial interests,

surely requires more than a mere argument or difference of opinion between the corporation and the suing stockholder as to the desirability of bringing the suit. Patently, if difference of opinion were all the "controversy" required to be shown between the stockholder and his corporation in order to preclude alignment of the latter with the plaintiff-stockholder, then there can be no occasion for all the pages of discussion of corporate domination or control, since every stockholder's derivative suit is by definition predicated upon the assumption that the corporation has refused to sue.

By §2 of Article III, the Constitution extends the federal judicial power "to controversies . . . between citizens of different States." This provision of the Constitution "simply gives to the . . . . courts the capacity to take jurisdiction . . . . it requires an act of Congress to confer it." [Kline v. Burke Construction Co., 260 U. S. 226, 234 (1922); The Mayor v. Cooper, 6 Wall. (73 U. S.) 247, 252 (1867).] And by act of Congress jurisdiction has been conferred upon federal district courts "where the matter in controversy exceeds the sum or value of $3,000 exclusive of interest and costs, and is between . . . citizens of different states. . . ." [28 U. S. C. §1332.]

The pleading requirements of old Equity Rule 94 [104 U. S. ix-x (1882); Ill. Cent. R. Co. v. Adams, supra, 180 U. S. at 34-35], and later Equity Rule 27 [226 U. S. 629, 656 (1913); Ashwander v. T. V. A., supra, 297 U. S. at 318], and present Rule 23(b) [Fed. Rules Civ. Proc., Rule 23(b), 28 U. S. C. A. at 83, 84-87] have not extended or otherwise altered jurisdiction.

As the Court explained in Venner v. Great Northern Ry., supra: "The jurisdiction . . . . is prescribed by

laws enacted by Congress in pursuance of the Constitution and this court by its rules has no power to increase or diminish the jurisdiction thus created, though it may regulate its exercise in any manner not inconsistent with the laws of the United States." [209 U. S. at 35.]

Moreover Rule 82 of the Federal Rules of Civil Procedure expressly provides that: "These rules shall not be construed to extend or limit the jurisdiction of the United States district courts. . . ." [Fed. Rules Civ. Proc., Rule 82, 28 U. S. C. A. at 499; see: Cohen v. Beneficial Ind. Loan Corp., supra, 337 U. S. at 556; Miss. Pub. Corp. v. Murphree, supra, 326 U. S. at 444-446.]

State-law concepts as to the nature of derivative suits cannot affect federal jurisdiction. [Cf. Ballantine, Corporations §§ 145-150 (Rev. Ed. 1946); Klopstock v. Superior Court, supra, 17 Cal. 2d 13, 108 P. 2d 906; Cantor v. Sachs, 18 Del. Ch. 359, 162 Atl. 73 (1932); see also Otis & Co. v. Pennsylvania R. Co., 57 F. Supp. 680, 683 (E. D. Penn. 1944), aff'd on opinion below, 155 Fed. 522 (3d Cir. 1946).]

Nor can federal jurisdiction be enlarged upon the theory that a stockholder's derivative suit is "ancillary" in character. [See e. g.: Mitchell v. Maurer, supra, 293 U. S. 237; Fulton Nat. Bank v. Hozier, 267 U. S. 276, 280 (1925); Hamer v. N. Y. Rys. Co., supra, 244 U. S. at 275; Phelps v. Oaks, 117 U. S. 236, 241 (1886); Stewart v. Dunham, 115 U. S. 61, 64 (1885); Feidler v. Bartleson, 161 Fed. 30, 35 (9th Cir. 1908); Oils, Inc. v. Blankenship, 145 F. 2d 354 (10th Cir. 1944), cert. denied, 323 U. S. 803 (1945); Johnson v. Sheppard Co., 2 F. R. D. 164 (D. Mass. 1941); 1 Barron & Holtzoff, supra, §23; Note, 64 Harv. L. Rev. 968-976 (1951).]

It has been settled from the beginning that diversity of citizenship exists only when all parties on one side of the controversy "are citizens of different states from all parties on the other side." [Indianapolis v. Chase National Bank, supra, 314 U. S. at 69; Hooe v. Jamieson, 166 U. S. 395 (1897); Coal Co. v. Blatchford, supra, 11 Wall. at 174-175; Strawbridge v. Curtiss, supra, 3 Cranch 267.]

And it is equally well settled that the "controversy" relied upon to invoke diversity jurisdiction must be "actual" [Helm v. Zarecor, supra, 222 U. S. at 36] and "substantial" [Niles-Bement-Pond Co. v. Iron Moulders Union, supra, 254 U. S. at 81], so as to constitute a justiciable "controversy" within the meaning of §2 of Article III of the Constitution. [See: Aetna Life Ins. Co. v. Haworth, 300 U. S. 227, 240-241 (1937); Ashwander v. T. V. A., supra, 297 U. S. at 318, 324-325; South Spring etc. Gold Min. Co. v. Amador etc. Gold Min. Co., 145 U. S. 300 (1892).]

A mere argument then, or even a heated debate, between a shareholder and his corporation over the advisability of bringing suit is not a "controversy" as that term is employed in §2 of Article III of the Constitution. But even if it were, it is not "the matter in controversy" with respect to which the court is duty-bound to align the parties to the action for the purpose of ascertaining whether requisite diversity of citizenship exists. [28 U. S. C. §1332.]

The "matter in controversy" referred to in 28 U. S. C. §1332 must be ascertained from the "principal purpose of the suit." [East Tenn. etc. Railroad v. Grayson, supra, 119 U. S. at 244.] Hence it is the duty of the court, in testing the claim of diversity jurisdiction, to arrange the

parties on opposite sides of "the primary and controlling matter in dispute." [Merchants' Cotton Press etc. Co. v. N. A. Ins. Co., 151 U. S. 368, 385 (1894); see Indianapolis v. Chase Nat. Bank, supra, 314 U. S. at 69-70.]

The "primary and controlling matter in dispute" in the case at bar is the contract between Warner Bros. and United. That contract is "the matter in controversy."

Only in cases where it appeared that the plaintiff-stockholder's corporation was "in antagonistic hands" [Koster v. Lumbermens Mutual Co., supra, 330 U. S. at 523], has the Court found that "difference or collision of interest" between stockholder and corporation as to "the matter in controversy" [Dawson v. Columbia Trust Co., supra, 197 U. S. at 181] which precludes alignment of the corporation with the stockholder in determining diversity jurisdiction.

And only in cases where it appeared that the plaintiff-stockholder's corporation was "dominated and controlled" by the alleged wrongdoers [Koster v. Lumbermens Mutual Co., supra, 64 F. Supp. 595, 596 (E. D. N. Y. 1945)], and so "made to act . . . subservient to some illegal purpose" [Doctor v. Harrington, supra, 196 U. S. at 587] or to engage in "the same illegal and fraudulent conduct" [Venner v. Great Northern Ry., supra, 209 U. S. at 32], has the Court found the corporation to be "in antagonistic hands."

Thus in each case the determinative fact is not whether the directors controlling the corporation are antagonistic to the suing stockholder, but whether those in control are shown to be antagonistic to the financial interests of the corporation.

In each case, moreover, the Court has considered the problem of whether or not the corporation was in "antagonistic hands" to be a question of fact, just as the requisite jurisdictional amount and the citizenship of the parties are questions of fact. [See: KVOS, Inc. v. Associated Press, supra, 299 U. S. 269; Gilbert v. David, supra, 235 U. S. 561; Pioneer Southwestern Stages v. Wicker, 50 F. 2d 581 (9th Cir. 1931); cf. Woodworkers Tool Works v. Byrne, 202 F. 2d 530 (9th Cir. 1953).] And in each case the record was such as to require the Court, in determining the proper alignment of the parties for jurisdictional purposes, to accept as true the "antagonistic hands" allegations of plaintiff's complaint.

In the case at bar, both the pleadings and the evidence are before the court to aid determination as to whether the case presents "a controversy wholly between citizens of different states, within the jurisdiction of the District Court." [Niles-Bement-Pond Co. v. Iron Moulders Union, supra, 254 U. S. at 82.] For here a trial was ordered as to the jurisdictional and the statute-of-limitations issues. [See: Gibbs v. Buck, supra, 307 U. S. at 71-72; Gulbenkian v. Gulbenkian, supra, 33 F. Supp. 19.]

Trial of these issues required more than fifteen days, a large volume of documentary evidence was received and the reporter's transcript runs some 2000 pages. As the size of this record indicates, the evidence adduced upon the trial of the jurisdictional issues was voluminous and complex, because those issues proved to be in many respects coextensive with issues as to the merits. [Cf. Land v. Dollar, supra, 330 U. S. at 735, 739; Calcote v. Texas Pac. Coal & Oil Co., 157 F. 2d 216, 218 (5th Cir. 1946), cert. denied, 329 U. S. 782 (1946); Williams v. Minn. Min. & Mfg. Co., 14 F. R. D. 1 (S. D. Cal 1952).]

No useful purpose would be served by relating the evidence in detail. It is sufficient here to say that the proofs adduced upon the trial compel the following findings of fact: (1) That the contract in controversy with United was and is considered by the eleven-man Board of Directors of Warner Bros. to be a sound business arrangement for the best present and future financial interests of the corporation; (2) that in approving and authorizing the contract, the members of the Board of Directors acted in good faith and exercised their independent business judgment; and (3) that at the time of the execution of the contract Albert Warner together with defendants Harry M. and Jack L. Warner owned less than 20% of the outstanding shares of the corporation; and neither the corporation nor the directors or officers were shown to be at any time under the domination or control of the three brothers Warner.

Accordingly, since no "collision of interest" appears between plaintiff and defendant Warner Bros.. the corporation will be aligned as a party plaintiff, and as such an alignment shows that the requisite diversity of citizenship does not exist [28 U. S. C. §1332], it follows as a matter of law that this court is without jurisdiction over the subject matter of the first cause of action asserted in the complaint.

This conclusion necessarily rests upon my understanding of the law: that whenever federal jurisdiction is invoked upon claimed diversity of citizenship in a stockholder's derivative suit, the court is free to inquire into the jurisdictional facts as in other cases and align the parties on either side of the "matter in controversy," and in so doing to determine as a fact whether or not the plaintiff stockholder's corporation is "in antagonistic hands" or so

dominated as to be incapacitated to act in its own financial interests.

It is recognized of course that my understanding of the law is in varying degrees at odds with the opinions of others. For example, see the following authorities not heretofore cited: Hutchinson Box & Paper Co. v. Van Horn, 299 Fed. 424, 428-429 (8th Cir. 1924); Hayms v. Calumet & Hecla Mining Co., 221 Fed. 529, 538 (6th Cir. 1915); Montro Corp. v. Prindle, 105 F. Supp. 460 (S. D. N. Y. 1952); Levitan v. Stout, 97 F. Supp. 105, 113 (W. D. Ky. 1951); Smallen v. Louisville Fire & Ins. Co., 80 F. Supp. 279 (W. D. Ky. 1948); Cohen v. Industrial Finance Corp., 44 F. Supp. 489, 490 (S. D. N. Y. 1941); Nagle v. Wyoga Gas & Oil Corp., 10 F. Supp. 905, 906 (M. D. Penn. 1935); Hodgman v. Atlantic Refining Co., 274 Fed. 104, 105 (D. Del. 1921); Whitaker v. Whitaker Iron Co., 238 Fed. 980, 990-991 (D. C. N. D. W. V. 1916), aff'd, 249 Fed. 531 (4th Cir. 1918), cert. denied, 248 U. S. 564 (1918); Crawford v. Seattle, R. & S. Ry. Co., 198 Fed. 920 (D. C. W. D. Wash. 1912); Howard v. National Telephone Co., 182 Fed 215, 220 (C. C. N. D. W. V. 1910).

In arriving at the conclusions here reached, these opinions and others previously cited have prompted great pause, not only because of the respect I hold for such differing views as to proper interpretation of precedent, but also because of reverence for *stare decisis*, the doctrine of judicial precedent, as the distinctively characteristic institution [Pound, The Spirit of the Common Law, 64-65, 182-183 (1921)], which gives necessary historic continuity to our common-law system of justice. [Holmes, Collected Legal Papers, 139 (1920); cf. Marshall v. B. & O. R. R. Co., 16 How. (57 U. S.) 314, 343 (1853).]

Study has brought the conviction that the views here expressed are not at variance with the authority of any precedent binding this court. Along the pathway to decision doubts have naturally arisen from the cases cited, and from the fact, that such scholarly judges as Chief Judge Learned Hand, with his colleagues Judges Chase and Clark of the Second Circuit, and Judge Wyzanski of the District of Massachusetts, appear to have regarded Doctor v. Harrington as fixing a rule—rather than stating a test—for alignment of the stockholder's corporation in derivative suits.

In Lavin v. Lavin, supra, 182 F. 2d 870, the Court said: "It may indeed be doubted whether as an original question the Supreme Court would not today align the corporation as a party plaintiff in all cases; nevertheless it has shown no disposition to change the rule in Doctor v. Harrington, 196 U. S. 579 . . . but has recognized its continued authority." [182 F. 2d at 871.]

In Ashley v. Keith Oil Corp. 73 F. Supp. 37 (D. Mass. 1947), Judge Wyzanski wrote: "If the question of federal jurisdiction were an open one, I should rule that there had not been compliance with the essentials set forth in United States Constitution, Article III, Section 2 and 36 Stat. 1091, 28 U. S. C. A. §41(1). Disregarding the form of the pleadings in this case, I should conclude that the parties should be realigned according to their real interest. That is, I should treat this as a suit by a Massachusetts corporation against a Massachusetts officer. 2 Moore's Federal Practice, 2272, 2273. Resort to such realignment is admittedly necessary and proper to determine whether in the case at bar there is involved the $3,000 which is a prerequisite to the exercise of diversity jurisdiction. . . . . Resort to such realignment seems the

only logically consistent course to determine whether in the case at bar there is involved the necessary diversity of citizenship. In addition to such logical considerations, I should have thought weight ought to be given to the fact that 'the dominant note in the successive enactments of Congress relating to diversity jurisdiction is one of jealous restriction, of avoiding offense to state sensitiveness. . . .' City of Indianapolis v. Chase National Bank, 314 U. S. 63, 76. . . ."

"But", Judge Wyzanski continues, "I am not a free agent. In 1905 the Supreme Court in Doctor v. Harrington, 196 U. S. 579 . . . held that the realignment which I would have thought proper is inapplicable where the corporation is in antagonistic hands. And only a few months ago, the Supreme Court . . . repeated the same doctrine to sustain federal jurisdiction in Koster v. (American) Lumbermens Mutual Casualty Co., 330 U. S. 518. . . . That was a derivative suit. . . . [and] . . . the justices of the Supreme Court in their majority and minority opinions seem to have concluded that diversity of citizenship existed. And, bowing to their judgment, I conclude that diversity of citizenship exists in the case at bar." [73 F. Supp. at 52-53.]

The very considerations of reason and policy which Judge Wyzanski mentions have prompted a search behind the equivocal language of Doctor v. Harrington to find there a flexible test for alignment of the plaintiff-stockholder's corporation, rather than a rigid rule of doubtful constitutionality. The same considerations have also prompted a look behind the language of Koster v. Lumbermens Mutual Cas. Co., supra, 330 U. S. at 523, to find a basis on which to conclude that it was never necessary there to reach the question of proper alignment of

the corporation for the purpose of ascertaining whether requisite diversity of citizenship existed.

For in Koster the doctrine of *forum non conveniens* was invoked and the first inquiry was "where trial will best serve the convenience of the parties and the ends of justice." [330 U. S. at 527.] Trial denotes a hearing and adjudication of issues of law as well as fact. It is axiomatic that a federal court always has "jurisdiction to determine its own jurisdiction" [United States v. United Mine Workers, 330 U. S. 258, 292-293, n. 57 (1947); Steele v. Culver, supra, 211 U. S. at 30]—the power to determine in every case whether the prerequisites to jurisdiction in fact exist. [See: Land v. Dollar, supra, 330 U. S. at 739; Texas & Pac. Ry. v. Gulf etc. Ry., 270 U. S. 266, 274 (1926).]

By the same token where, as in Koster, the doctrine of *forum non conveniens* is invoked, the court in which the action pends has the power to determine, and no doubt should first determine, the *forum conveniens* in which the issues of law and fact, including issues of law and fact as to federal jurisdiction, ought to be tried.

In Koster, the District Court applied the doctrine of *forum non conveniens* and dismissed the action. [Id. 64 F. Supp. 595.] The Court of Appeals affirmed. [Id. 153 F. 2d 888.] The Supreme Court granted certiorari [id. 329 U. S. 700], and at the outset Mr. Justice Jackson explained. "This case involves the special problems of *forum non conveniens* which inhere in derivative actions, and which have been little considered by this Court." [330 U. S. at 521.]

The Court then proceeded to affirm the holding below "that the case should not be tried in New York as there

was ample remedy available in the state and federal courts of Illinois" [iden], thus leaving open for trial in the federal courts of Illinois, if suit were later filed there, all issues of fact and law as to federal jurisdiction presented by Koster's case.

Both logic and sound judicial administration combined to dictate that the proceedings in Koster take such a course. The case at bar is an apt example of the possible breadth of issues of fact and law necessary to be tried in determining whether diversity jurisdiction exists. [Cf. Hammerstein v. Superior Court, 341 U. S. 491 (1951); Layne etc. Co. v. Western Well Works, 261 U. S. 387, 392-393 (1923).]

A review of the cases in their historical settings [see Quincy v. Steel, supra, 120 U. S. at 244-246] gives the impression that the equivocal discussion of the problem of diversity jurisdiction in Doctor v. Harrington, supra, 196 U. S. at 587, resulted from the Court's preoccupation with the problem of collusive suits; that the obvious collusion in Hawes v. Oakland, supra, 104 U. S. at 461, and the apparent lack of collusion in Greenwood v. Freight Co., supra, 105 U. S. at 16, prompted Mr. Justice Miller to write opinions which in effect rejected diversity jurisdiction in Hawes and sustained it in Greenwood, without mentioning his well reasoned opinion as Circuit Justice in Arapahoe County v. Kansas Pac. Ry. Co., supra, 1 Fed. Cas. 1080. [But cf. Bourdieu v. Pacific Oil Co., supra, 299 U. S. at 70-71.]

It is hardly necessary to add that the decision in the case at bar could correctly have consisted of a reference to what Mr. Justice Miller so well said in Araphoe, for this case is in fact on all fours with Arapahoe insofar as

determination of alignment of parties for purposes of diversity jurisdiction is concerned.

In my opinion the Constitution and every relevant consideration of reason and policy join forces to argue that differences of fact alone—and not of law—explain how it was possible for diversity jurisdiction to be sustained in both Arapahoe and Doctor v. Harrington.

This conclusion is reinforced by what was so clearly expounded in Kline v. Burke Construction Co., supra: "The right of a litigant to maintain an action in a federal court on the ground that there is a controversy between citizens of different States is not one derived from the Constitution of the United States, unless in a very indirect sense. Certainly it is not a right granted by the Constitution. The applicable provisions, so far as necessary to be quoted here, are contained in Article III. Section 1 of that Article provides, 'The judicial power of the United States shall be vested in one Supreme Court, and in such inferior courts as the Congress from time to time ordain and establish.' By §2 of the same Article it is provided that the judicial power shall extend to certain designated cases and controversies and, among them, 'to controversies . . . between citizens of different States. . . .' The effect of these provisions is not to vest jurisdiction in the inferior courts over the designated cases and controversies but to delimit those in respect of which Congress may confer jurisdiction upon such courts as it creates. Only the jurisdiction of the Supreme Court is derived directly from the Constitution. Every other court created by the general government derives its jurisdiction wholly from the authority of Congress. That body may give, withhold or restrict such jurisdiction at its discretion, provided it be not extended beyond the boun-

daries fixed by the Constitution." [260 U. S. at 233-234. See: Hart, The Power of Congress to Limit the Jurisdiction of the Federal Courts, 66 Harv. L. Rev. 1362 (1953).]

To this should be added the policy stated by Mr. Justice Stone in Healy v. Ratta, 292 U. S. 263 (1934): "The power reserved to the states, under the Constitution, to provide for the determination of controversies in their courts may be restricted only by the action of Congress in conformity to the judiciary sections of the Constitution. . . . Due regard for the rightful independence of state governments, which should actuate federal courts, requires that they scrupulously confine their own jurisdiction to the precise limits which the statute has defined." [292 U. S. at 270. Compare: 28 U. S. C. §1441(c); Lewin, The Federal Court's Hospitable Back Door, 66 Harv. L. Rev. at 423 (1953).]

Thus all seeming technicalities surrounding federal jurisdiction based upon claimed diversity of citizenship are actually safeguards against unintended violation of the jurisdiction constitutionally reserved to the states. As the Court expressed it in Indianapolis v. Chase National Bank, supra: "These requirements, however technical seeming, must be viewed in the perspective of the constitutional limitations upon the judicial power of the federal courts, and of the Judiciary Acts in defining the authority of the federal courts when they sit, in effect, as state courts." [314 U. S. at 76.]

It is more than costly error therefore—it is an unconstitutional invasion of the jurisdiction of the state courts—for a federal court to sustain federal jurisdiction of a civil action between private persons where "the matter in

controversy" exceeds the sum or value of $3,000, exclusive of interest and costs, but does not arise "under the Constitution, laws or treaties of the United States" [28 U. S. C. §1331], and diversity of citizenship as to "the matter in controversy" does not exist. [U. S. Const. Art. III; 28 U. S. C §1332. See: American Fire & Cas. Co. v. Finn, 341 U. S. 6, 17-18 (1951); Skelly Oil Co. v. Phillips Co., 339 U. S. 667, 671-674 (1950); Shamrock Oil Co. v. Sheets, 313 U. S. 100, 108-109 (1941); Shields v. Barrow, supra, 17 How. at 145.]

So whenever the party invoking federal jurisdiction cannot sustain his burden of proof to show existence of "the grounds upon which the court's jurisdiction depends" [Fed. Rules Civ. Proc., Rule 8(a), (b), 28 U. S. C. A. at 252-253; KVOS, Inc. v. Ass. Press, supra, 299 U. S. at 278; McNutt v. Gen. Motors etc. Corp., supra, 298 U. S. at 187-190; Seslar v. Union Local 901, supra, 186 F. 2d at 407; 1 Barron & Holtzoff, supra, §352 (1952 Supp.)], the proper order always is to dismiss the action for lack of jurisdiction, regardless of whether the factual issues involved in this determination be simple or complex, since when "beyond the Constitution . . . every act must be a violation of duty, an usurpation." [Marshall v. B. & O. R. R. Co., supra, 16 How. at 343.]

Dismissal in the federal courts for lack of jurisdiction can in no way prejudice the bringing of the action in a court of competent jurisdiction, because a judgment of dismissal for want of jurisdiction is not res judicata as a final decision upon the merits and consequently does not bar a subsequent action. [Southern Pacific Co. v. Bogart, 250 U. S. 483, 490 (1919); Smith v. McNeal, 109 U. S. 426, 429,430 (1883); Hughes v. United States, 4 Wall. (71 U. S.) 232, 237 (1866); Walden v. Bodley,

14 Pet. (39 U. S.) 156 (1840); Bunker-Hill & Sullivan Min. & C. Co. v. Shoeshine Min. Co., 109 Fed. 504, 507 (9th Cir. 901).]

So also the findings of this court which serve as predicate for the conclusion that the plaintiff-stockholder's corporation is not in "antagonistic hands" cannot operate to bar contrary findings by a court having plenary jurisdiction of the case, since the collateral estoppel doctrine is not applicable to such interlocutory or "incidental" determinations of fact [Restatement, Judgments §71 (1942); Scott, Collateral Estoppel By Judgment, 56 Harv. L. Rev. 1, 18-22 (1942); cf. United States v. International Bldg. Co., 345 U. S. 502, 504-505 (1953); Zank v. Landon, 205 F. 2d 615 (9th Cir. 1953); Sachs v. Ohio Nat. Life Ins. Co., 148 F. 2d 128 (7th Cir. 1945), cert. denied, 326 U. S. 753 (1945); Musher Foundation v. Alba Trading Co., 127 F. 2d 9, 11 (2d Cir. 1942), cert. denied, 317 U. S. 641 (1942); contra: Simmons v. Superior Court, 96 Cal. App. 2d 119, 125, 214 P. 2d 844, 849 (1950)], made in the exercise of the power to determine jurisdiction. [Land v. Dollar, supra, 330 U. S. at 735.]

What has been said relates to the first cause of action. It remains to consider whether this court has jurisdiction over the second cause of action which the plaintiff-stockholder asserts against defendants Harry M. and Jack L. Warner only, omitting defendants United and Sperling.

There exists diversity of citizenship as to the second cause of action unless United is an indispensable or necessary party to it, for without United the "matter in controversy" would be between the New York plaintiff-stockholder and his Delaware corporation, Warner Bros., both aligned on one side, with the two brothers Warner, citizens of California, aligned on the other.

In essence, this second count or claim is that by causing United States Pictures, Inc., a Delaware corporation, to be formed, and by causing defendant Warner Bros. to enter into the challenged contract with United, the two defendant-directors allowed the assets of Warner Bros. to be dissipated for the benefit of United and Sperling; and that this failure of the individual defendants to live up to their fiduciary duties as directors of Warner Bros. caused large pecuniary loss to the corporation.

Thus plaintiff asks this court, in the exercise of its equity jurisdiction, to render a money judgment for damages in favor of defendant Warner Bros. based upon the allegedly improvident and fraudulent contract with United, while leaving the contract in force to govern future relationships between United and Warner Bros., merely because plaintiff has chosen for reasons of his own to name United as a party defendant to the first cause of action but not to the second. [Cf. Twist v. Prairie Oil Co., 274 U. S. 684, 689-692 (1927).]

It is true of course that whenever diversity jurisdiction exists, plaintiff's "motive in preferring a Federal tribunal is immaterial." [Chicago v. Mills, supra, 204 U. S. at 330; Blair v. Chicago, 201 U. S. 400, 448-449 (1906).] But even when diversity jurisdiction exists, the case may not be such as to warrant exercise of the equity jurisdiction of the court. [See: Matthews v. Rogers, 284 U. S. 521, 524 (1932); Twist v. Prairie Oil Co., supra, 274 U. S. at 690; Venner v. Great Northern Ry., supra, 209 U. S. at 34; Reynes v. Dumont, 130 U. S. 354, 395 (1889).]

As the Court observed in Twist v. Prairie Oil Co., supra, "the objection that the case is not within the equity

jurisdiction . . . . does not go to the power of the Court as a federal Court." [274 U. S. at 691.]

So in the case at bar, although diversity jurisdiction may exist as to the second cause of action, the question still remains whether the second cause of action is within the equity jurisdiction of this court; and the answer to that question turns upon whether or not United is an indispensable party to proper adjudication of the second cause of action.

Rule 19(a) of the Federal Rules of Civil Procedure does not attempt affirmatively to define who are indispensable parties, but does restate existing law. [Fed. Rules Civ. Proc., Rule 19, 28 U. S. C. A. at 36; Wesson v. Crain, 165 F. 2d 6, 8-9 (8th Cir. 1948); Chidester v. City of Newark, 162 F. 2d 598, 600 (3d Cir. 1947); Young v. Garrett, 149 F. 2d 223, 228 (8th Cir. 1945); Cather v. Ocean Acc. etc. Co., 94 F. Supp. 511, 514-515 (D. Neb. 1950).]

Rule 19(b) provides that: "When persons . . . who ought to be parties if complete relief is to be accorded between those already parties, have not been made parties and are subject to the jurisdiction of the court as to both service of process and venue. . . . The court in its discretion may proceed in the action without making such persons parties, if . . . their joinder would deprive the court of jurisdiction of the parties before it; but the judgment rendered therein does not affect the rights or liabilities of absent persons." [Fed. Rules Civ. Proc., Rule 19(b), 8 U. S. C. A. at 36; cf. Louisville etc. R. Co. v. Letson, supra, at 555-556.]

Hence Rule 19(b) permits the court, in the exercise of discretion, either to proceed or not proceed to judg-

ment without absent parties "who ought to be parties if complete relief is to be accorded between those already parties." [See: Bourdieu v. Pac. Oil Co., supra, 299 U. S. at 70-71; California v. Southern Pac. Co., 157 U. S. 229, 255 (1895).]

While not an indispensable party in the sense of "having a joint interest" and for that reason subject to "necessary joinder" by the terms of Rule 19(a), United is clearly a person who "ought to be" a party within the meaning of Rule 19(b). In the language of Niles-Bement-Pond Co. v. Iron Moulders Union, supra: "There is no prescribed formula for determining in every case whether a person or corporation is an indispensable party or not, but a rule early announced and often applied by this court is sharply applicable to the case at bar. In Shields v. Barrow, 17 How. 130, 139, this language . . . was used to describe parties so indispensable that a court of equity will not proceed to final decision without them, viz:

"'Persons who not only have an interest in the controversy, but an interest of such a nature that a final decree cannot be made without either affecting that interest, or leaving the controversy in such a condition that its final termination may be wholly inconsistent with equity and good conscience.'" [254 U. S. at 80. See: State of Washington v. United States, 87 F. 2d 421, 427-428 (9th Cir. 1936); I. C. C. v. Blue Diamond etc. Co., 192 F. 2d 43, 47 (8th Cir. 1951).]

No extended discussion is necessary to point out why a decree by this court as to the second cause of action without the presence of United before the court would leave the controversy "in such a condition that its final termination may be wholly inconsistent with equity and

good conscience." [Shields v. Barrows, supra, 17 How. at 139.]

It is therefore my opinion that, as to the second cause of action, United is one of the "parties so indispensable that a court of equity will not proceed to final decision without them" [Niles-Bement-Pond Co. v. Iron Moulders Union, supra, 254 U. S. at 80; cf. Lee v. Lehigh Valley Coal Co., supra, 267 U. S. at 543; Walden v. Skinner, supra, 101 U. S. at 589; Wormley v. Wormley, supra, 8 Wheat. at 45; Arapahoe County v. Kansas Pac. Ry. Co., supra, 1 Fed. Cas. at 1082-1083], "since a final decree could not be made without . . . leaving the controversy in a condition wholly inconsistent with that equity which seeks to put an end to litigation by doing complete and final justice." [Niles-Bement-Pond Co. v. Iron Moulders Union, supra, 254 U. S. at 81.]

The doctrine of pendent jurisdiction, even if applicable here, could not operate to alter the conclusion just stated. [See, seriatim: Osborn v. Bank of the United States, supra, 9 Wheat. at 822-82 ; Siler v. Louisville & N. R. R. Co., 213 U. S. 175 (1909); Hurn v. Oursler, 289 U. S. 238, 245-246 (1933); Montana-Dakota Co. v. Pub. Serv. Co., 341 U. S. 246 (1951).]

Accordingly the second cause of action will be dismissed for want of equity [Mallow v. Hinde, 12 Wheat. (25 U. S.) 193, 199 (1827)], and the judgment of dismissal shall expressly declare that it does not "operate as an adjudication upon the merits" and is without prejudice or res judicata effect. [See Fed. Rules Civ. Proc., Rule 41(b), 28 U. S. C. A. at 379-380; Barney v. Baltimore, supra, 6 Wall. at 284-285, 287, 289.]

Discretion to dismiss is exercised in the face of high probability that plaintiff will confront a plea of the bar

of a three-year statute of limitations in the event this suit should now be filed in a California court of competent jurisdiction. [See: Cal. Code Civ Proc. §§335, 338(4), 359, 361; Bovay v. H. M. Byllesby & Co., supra, 27 Del. Ch. 381, 38 A. 2d 808.]

If the action were not already barred when commenced here, the courts of California might hold that the applicable statute of limitations was tolled during the pendency in this court, since it is the policy of the California law, as expressed in §396 of the Code of Civil Procedure, that: "If an action or proceeding is commenced in a court which lacks jurisdiction of the subject matter thereof, as determined by the complaint or petition, if there is a court of this State which has such jurisdiction, the action or proceeding shall . . . be transferred to a court having jurisdiction of the subject matter. . . ." [See: Morgan v. Somervell, 40 Cal. App. 2d 398, 104 P. 2d 866 (1940).]

The literal terms of this statute preclude its application to an action brought in a federal court, as there is no machinery for transfer such as the statute requires. [Cal. Code Civ. Proc. §396.] Resort may be had, however, to reasoning by analogy from the statute. This common-law technique involves the age-old principle of the "equity of the statute," requiring that a legislative enactment be treated as a declaration of policy which serves as precedent in analogous situations not expressly covered by the statute itself.

The equity-of-the-statute principle presupposes that the legislature-made precedent is entitled to recognition comparable to that accorded judge-made precedent, and application of the principle necessarily invokes the concept of *stare decisis* to employ the statue as a precedent-making

declaration of legislative policy. [See: United States v. Freeman, 3 How. (44 U. S.) 556, 565 (1845); Stone, The Common Law in the United States, 50 Harv. L. Rev. 4, 12 (1936); Landis, Statutes and the Sources of Law, Harvard Legal Essays, 213, 214-218 (1934); Pound, Common Law and Legislation, 21 Harv. L. Rev. 386 (1908).] As Mr. Justice Frankfurter observed upon dissenting in Pope v. Atlantic Coast Line R. Co., 345 U. S. 379 (1953): "Statutes . . . are not to be deemed self-enclosed instances; they are to be regarded as starting points of reasoning, as means for securing coherence and for effectuating purpose." [345 U. S. at 390. Cf. United States v. Atlantic Mutual Ins. Co., 343 U. S. 236, 245-249 (dissenting opinion, 1952); Panama R. R. Co. v. Rock, 266 U. S. 209, 215-216 (dissenting opinion, 1924); Johnson v. United States, 163 Fed. 30, 32 (Holmes, Circuit Justice, 1st Cir. 1908.]

In considering the availability of a state court of competent jurisdiction to redress plaintiff's grievances which are asserted in the second cause of action, it should be remarked that there are now pending in the Supreme Court of New York County, New York, nine derivative suits by stockholders of Warner Bros. similar to that at bar, none of which are on calendar and most of which have long been stayed because of failure of compliance with the New York court's order for security for costs. [See: N. Y. Gen. Corp. Law, §61; Shielcrawt v. Moffett, 294 N. Y. 180, 61 N. E. 2d 435 (1945); Noel Associates, Inc. v. Merrell, 184 Misc. 646, 63 N. Y. S. 2d 143 (1944); Fed. Rules Civ. Proc., Rule 23, Notes of Advisory Committee, 28 U. S. C. A. at 83-87.]

And it should be noted also that any stockholder's derivatve suit filed in the California courts must confront

the possibility that security for costs may now be required in such cases. [See: Cal. Corp. Code §834, Stats. 1949, p. 857; Hogan v. Ingold, 38 Cal. 2d 802, 243 P. 2d 1 (1952); Cohen v. Beneficial Ind. Loan Corp., supra, 337 U. S. 541.]

The conclusions reached as to the jurisdictional issues make it unnecessary to express any opinion on the issues raised by defendant's plea of the bar of applicable statutes of limitations.

Defendants will lodge with the Clerk proposed findings of fact, conclusions of law and judgment of dismissal pursuant to local rule 7 within ten days.

December 16, 1953.

WM. C. MATHES
United States District Judge

SUBJECT INDEX

PAGE

Opinions below 1

Jurisdiction 1

Constitutional provisions, statute, and rule involved 2

Questions presented 3

Statement 4

Argument 14

I.

There is neither precedent nor is there valid reason for ruling that a stockholder's corporation is properly aligned as a defendant in a derivative suit, only when shown to be "dominated and controlled" by the co-defendants 14

II.

The Warner directorate is, avowedly, on the defendants' side of the matter in controversy: It was error to realign the corporation as a complainant 22

Conclusion 25

TABLE OF AUTHORITIES CITED

CASES — PAGE

Ashwander v. Tennessee Valley Authority, 297 U. S. 288 16
Chicago v. Mills, 204 U. S. 321 21
Delaware & Hudson v. Albany & Susquehanna, 213 U. S. 435 ..... 16, 19, 21, 22
Doctor v. Harrington, 196 U. S. 579 ..... 14, 16, 17, 18, 20, 21, 23
Gratz v. Murchison, 130 Fed. Supp. 709 15
Groel v. Electric Co., 132 Fed. 252 21
Hawes v. Oakland, 104 U. S. 450 ..... 21, 22
Helm v. Zarecor, 220 U. S. 36 ..... 17, 23
Indianapolis v. Chase Bank, 314 U. S. 62 ..... 18, 22, 23
New Jersey v. Mills, 113 U. S. 249 ..... 14, 15
Pacific R.R. v. Ketchum, 101 U. S. 289 ..... 17, 23
Railroad v. Grayson, 119 U. S. 240 ..... 14, 15, 21
The Central Railroad Co. v. Mills, 113 U. S. 249 21
Venner v. Great Northern Railroad, 209 U. S. 24 ..... 14, 19, 23

RULES

Federal Rules of Civil Procedure, Rule 23(b) 2, 21

STATUTES

Act of June 25, 1948, Chap. 646 (62 Stats. 928) 1
Act of June 25, 1948, Chap. 646 (62 Stats. 930) 2
Equity Rules, Rule 94 ..... 18, 21
United States Code, Art. III, Sec. 2 2
United States Code, Title 28, Sec. 1254(1) 1
United States Code, Title 28, Sec. 1332(a)(1) 2
United States Constitution, Art. III, Sec. 1 2

IN THE

Supreme Court of the United States

October Term, 1956

No. 316.

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the District Court rendered December 16, 1953 is reported in 117 Fed. Supp. 781. The opinion of the Court of Appeals [R. 665-673] filed May 21, 1956 is reported in 237 F. 2d 317.

Jurisdiction.

The judgment of the Court of Appeals was entered on May 21, 1956. The petition for certiorari was filed with the clerk of this Court on August 13, 1956. The jurisdiction of this Court is invoked under Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C., Section 1254(1).

Constitutional Provisions, Statute, and Rule Involved.

Article III, Section 1, Constitution of the United States, provides, in part: "The judicial power of the United States, shall be vested in one supreme court, and in such inferior courts as the Congress may from time to time ordain and establish."

Article III, Section 2, Constitution of the United States, provides, in part: "The judicial power shall extend to * * * controversies * * * between citizens of different States * * *."

Act of June 25, 1948, c. 646, 62 Stat. 930, Title 28, Section 1332(a) (1), United States Code, provides, in part: "(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $3,000 exclusive of interest and costs, and is between: (1) Citizens of different States * * *."

Rule 23(b) of the Federal Rules of Civil Procedure provides:

> "(b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the

plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

Questions Presented.

Jurisdiction based on diversity of citizenship is present in the first count of this stockholder's derivative suit, only if the corporation was properly aligned as a *defendant*. If—as the courts below have decided—the corporation must be realigned as a complainant because the stockholder failed to prove that the corporation was "dominated and controlled" by the codefendants, then diversity of citizenship is lacking. The questions presented are:

1. Where the directorate of a corporation which is *not* dominated or controlled by its president or vice-president is, nevertheless, admittedly opposed to a stockholder's claim asserted in a derivative suit in a federal court viz: his corporation is dealing unfairly with a corporation which is owned by the president's son-in-law and causing him to become unjustly enriched at the expense of the stockholder's corporation; where these directors are avowedly hostile to the suit and its objects; where the stockholder's corporation appears in the action, unites with its president and vice-president in resisting the stockholder's claim of illegality; unites with them in opposing his prayer that the Court terminate the dealings and cancel the contract between the two companies and prays the complaint be dismissed; where counsel for the stockholder's corporation admits in open Court "no matter what demand the plaintiff

stockholder had made on the directors, they would never have brought this suit"; is not the stockholder's corporation rightly aligned as a defendant in such a suit?

2. Was it not error to destroy diversity of citizenship and consequently jurisdiction over this controversy by realigning the stockholder's corporation as a complainant and then to dismiss for failure of jurisdiction?

Statement.

Edward S. Birn, a New York citizen and stockholder of Warner Brothers Pictures, a Delaware corporation, invoked the diversity jurisdiction of the United States District Court for the Southern District of California in two causes of action of a derivative suit.

Named as defendants in the first cause were the corporation (Warner corporation or "Warner" for short), its president and vice-president, Harry Warner and Jack Warner, both citizens of California; the president's son-in-law, Milton Sperling, a California citizen; and United States Pictures ("United" for short), a Delaware corporation owned by Sperling and his two children. [R. 378-380.]

Named as defendants in the second cause were the Warner corporation and Harry and Jack Warner. Sperling and United were not named in this second cause. [R. 11:]

The gist of the claim: Dealings between Warner and United in a motion picture joint venture, terms of which were negotiated by president Harry Warner with his son-in-law Sperling [R. 116, 129, 136, 169] and incorporated

into a Warner-United contract and a series of amendments thereto, are unlawful and are enriching Sperling unjustly at Warner's expense. [R. 5, 8-10.] Complainant prayed the Court to halt the dealings between the two companies, terminate their relationship, cancel their contract [R. 15], and for other relief.

Warner appeared in the suit and combined with the co-defendants in resisting complainant's claim and prayer: In a joint answer with the brothers Harry and Jack Warner who were charged with a breach of trust in connection with Warner-United dealings, Warner denied complainant was a citizen of New York [R. 20]; denied the truth of his claim [R. 20-24]; pleaded the bar of the Statutes of Limitations of three states [R. 24-25], and prayed the complaint be dismissed. [R. 26.] United and Sperling entered a similar plea. [R. 16-20.]

The merits of the controversy, *i.e.*, whether the Warner-United dealings are in fact unlawful and should be terminated and whether the Warner-United contracts should be ordered canceled to the extent that they remain unexecuted, *were not reached.* [R. 583.] The Court ordered that two issues,

(1) Jurisdiction, and

(2) The bar of the Statutes of Limitations,

be inquired into preliminarily [R. 72, 572, 586] before it would consider the merits. [R. 583.] The parties were directed to appear and present evidence *"only as to those issues."* [Findings, R. 72.] "Thereupon, evidence on behalf of plaintiff and defendants was offered and received, *the cause argued and submitted upon the two above stated issues only."* [R. 72; emphasis added.]

The inquiry into jurisdiction unfolded the following realities: Complainant Birn was a citizen of New York. The defendants are all citizens of states other than New York. [R. 73.]

Warner is owned by the public; its stock is listed and traded on the New York Stock Exchange. [R. 119.] Some 30,000 persons located all over the world are its shareholders. [R. 120.]

Three of the stockholders, namely the brothers, Harry, Jack and Albert Warner, have a working control of the company: They own between 15 and 20 per cent of its outstanding stock. [R. 75, 120.] They are the company's managers [R. 112]; they "run" the company [R. 259-260]; they control its over-all—its basic policies [R. 492]; they control the naming of Board members [R. 195, 283-284, 291, 305-306] and the re-election of directors at the expiration of their terms; and the employment of these men by the company in various capacities at substantial salaries and retainers. [R. 195-196, 490, 600.]

The likelihood of sitting on the Warner Board unless one stays acceptable to the brothers Warner is virtually nil: Three directors (out of eight who, along with the brothers compose the Board) *admit,* in substance, that to become *persona non grata* to the brothers would mark the end of their relationship with the company. [R. 490, 304-305, 291-292.]

Each of the three gentlemen, namely, Mr. Friedman, Mr. Perkins and Mr. Wolf, derives a substantial income from the company. [R. 600.]

The composition of the Warner Board is controlled by Harry Warner. Director Carlisle says, in so many words,

that Harry Warner controls the naming of Board members and that Harry and his two brothers control whether or not Carlisle [he draws a substantial salary as Comptroller, R. 600], stays on in the company's employ. [R. 195-196.]

Two other directors, namely Guggenheimer and Catchings, admit in substance, that their presence on the Board is virtually at the brothers' pleasure. [R. 283-285, 264.] Mr. Guggenheimer is the senior member of a law firm under retainer to Warner. [R. 271, 600.]

Proxy machinery—set in motion annually—serves to perpetuate an environment in which the brothers Warner exercise this admitted mastery and sway: A month or so before stockholders' annual meetings, which are held in Delaware, the gentlemen on the Board nominate themselves and then stand for re-election [R. 260-261]; paid agents —paid by the company—are employed to campaign for them by mail and telephone. Stockholders are solicited to appoint as their proxies a "proxy committee" the membership of which is admittedly candidate-chosen; the proxies garnered then serve to rubber-stamp, so to speak, the candidates' choice of themselves as their successors. [R. 597-599.] The expense of "—preparing, handling, and mailing the proxy statement and the proxy and the charges of brokerage houses and other custodians—" are paid by the company. [R. 598.]

Each of the six gentlemen aforenamed were seated on the Warner Board, without interruption, during many years preceding and following the institution of the suit. [R. 27.]

Warner produces motion pictures in vast studios which it maintains in California. Subsidiary companies distribute its product throughout the world. [R. 117, 118-119.] Harry Warner is Warner's Chief Executive. [R. 119.] Sperling is his son-in-law.

Ever since September 28, 1945, the two corporations Warner and United, have been engaged in a joint venture in motion picture production—distribution: On that day, Albert Warner informed a quorum composed of himself and the six aforenamed Warner directors [R. 605] that the brothers Warner favored the corporation's entering into an arrangement with United [R. 191, 193-194, 493], a newly formed company owned by Sperling and Joseph Bernhard[1] whereby Warner shares with United the costs and profits of six feature pictures, to be produced two each year during the ensuing three-year period. All seven gentlemen who comprised the quorum recorded their ap-

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[1]Bernhard was a Warner director, employed by the company as a "managing executive" for which he was paid $3,000 a week. [R. 603-604.] He managed Warner theatres. He had no experience in making pictures [R. 126-327], but he had good connections with the New York Trust Company. [R. 123.] John Bierworth, president of that bank, was his friend. [R. 122.]

A few months before, Harry Warner had suggested to Bernhard that Harry and brother Jack would approve of Warner's entering into a profit-sharing venture with a company owned by Bernhard and Sperling in equal shares, if Bernhard could get the New York Trust Company to loan such a Bernhard-Sperling company half of the production cost of a series of pictures. [R. 124-125.]

Bernhard obtained the commitment from Bierworth [R. 128]; gave up his $156,000 a year job with Warner [R. 602-603]; United was formed; Sperling acquired one-half of its stock for $12,500 and Bernhard the other half for a like sum. [R. 130.] Less than a year later Bernhard sold his stock interest in United to Sperling for $400,000 cash—a profit of $387,500. [R. 135, 163-164.]

proval.[2] The arrangement was embodied in a written contract. [R. 607-651.] Negotiators of its terms were Harry Warner and Jack Warner with Sperling and Bernhard. [R. 116, 129, 161.] Stockholders' approval thereof was neither sought[3] nor obtained. [R. 31.]

On December 6, 1947, a few months before the three-year venture period provided by the Warner-United contract was due to expire (and only three of the six pictures had been produced), Harry and Jack Warner, acting for Warner, and Sperling for United [R. 136] negotiated an amendment [Ex. 4; R. 651-656] whereby the life of the venture was extended to and including the year

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[2]None of the seven men who composed the quorum faced the Court, except Friedman. Their depositions, taken in New York at the instance of the defendants, were read. Each was asked the question, namely, had anyone told him how he should vote on the matter, and each replied in the negative. [R. 177, 249, 275, 287, 297, 457.] Four were asked the question, namely, did (the witness) exercise his own independent judgment in casting his vote, and each replied in the affirmative. [R. 177, 249, 275, 297.]

[3]Sperling's connection with the venture was withheld from the stockholders: In two paragraphs captioned "Transactions Between the Corporation and Directors", the 1946 Proxy Statement revealed to stockholders that Warner and United were engaged in a motion picture venture; that *Bernhard*, a former Warner director, was financially interested in United. The Statement made no mention of Sperling. [R. 600-601.]

Three of the six aforenamed Warner directors collaborated in drafting this statement: Friedman, Perkins and Carlisle. [R. 482, 485.] Friedman testified the two paragraphs "were intended to satisfy S.E.C. regulations and in addition to that, *put stockholders on inquiry* with respect to a transaction had between the corporation and a relative of its chief executive—" [Emphasis added; R. 484.]

Queried as to whether the directors thought Sperling's financial interest in the venture and his being the president's son-in-law "had better not be mentioned", Mr. Friedman replied that after giving the matter consideration, it was the concensus of opinion "that it need not be mentioned." [R. 485.]

1950; its scope was broadened—three more pictures were added—and Warner became obligated to provide thenceforth, not 50%, but the whole—100 per cent—of the venture's capital requirements.[4]

On July 21, 1950—some five months before the venture was again about to end, with five pictures remaining unproduced—Harry and Jack Warner, acting for Warner, and Sperling for United, negotiated another amendment to the Warner-United contract. [R. 169.] This time, the life of the venture was extended to January 1, 1953; three additional pictures were to be produced; Warner was obligated to furnish 100% of the capital.

Again on August 12, 1952, as the venture was once again about to come to an end, a further amendment—negotiated between Harry Warner, Jack Warner and Sperling—set its expiration date ahead to January 1, 1956; added two more pictures to be produced with 100% Warner capital, and brought up to a total of fifteen, the number of pictures embraced in the venture. [R. 169, 606.]

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[4]By this time, Sperling and his two infant children owned all of United: Bernhard was out. Sperling had bought Bernhard's 125-share stock interest in United and had placed 62 shares in two trusts for the benefit of his two children—Harry Warner's grandchildren. [R. 135-136.] And at this time, Harry Warner had a *personal financial* interest in United: The New York Trust Company loaned United $150,000 on a demand note secured by Harry Warner's personal endorsement. [R. 381-382, 496-497.] The note was unpaid. [R. 382.]

Eight pictures have been produced. A ninth is in the making [R. 154-155] and six are slated to follow, all in a course of dealing between the two corporations that complainant stockholder contends is unlawful, wasteful, unfair to Warner and which is causing Sperling's unjust enrichment at Warner's expense[5], and the corporation contends is lawful, fair, advantageous and furthermore, that the Statutes of Limitations of three states bar the right to the relief prayed for.

After the foregoing realities had been made evident, the inquiry came to a close when the counsel for Warner corporation *admitted* that stockholder and corporation are at odds and occupy opposing positions in the controversy over the legality of the Warner-United relationship; admitted that the Warner directors are inimical and opposed to the suit; ". . . . the defendants' position is that this was an advantageous arrangement to the Warner

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[5]*e.g.* In addition to profits paid to United, pursuant to Subdivision j of the Warner-United Contract [R. 626] which entitles United to receive profits derived from a successful picture, despite losses suffered by the venture in *subsequent* unsuccessful pictures, *Sperling* admits to having received (up to April 2, 1953, the date of answers to requests for admissions), in excess of half a million dollars as salaries and expenses [R. 170] in his twin capacities of "producer" of pictures and "executive" of United. [R. 620.]

This money was charged into the production costs of pictures made and was paid Sperling pursuant to the provisions of subparagraph 4½ of Paragraph 7 of the Warner-United contract. [R. 620.] This paragraph provides in substance, that United's "overhead", unlimited in terms of dollars, is chargeable into the production cost of the pictures and that Sperling's "executive" salary, also unlimited in terms of dollars, be considered a part of such overhead.

corporation and the directors would have upheld it at any time against any attack by any person, including any group of stockholders" and admitted that a demand on the directors, by complainant or by any group of stockholders, that the corporation bring suit against the co-defendants, would have been unavailing. [R. 587-588.]

In short, the inquiry closed [R. 586-587] on the concession by counsel for the Warner corporation that the company was not on the complainant's, but on the defendants' side of the matter in controversy. It sided with them, said the counsel, not because the Warner directorate is dominated and controlled by the co-defendants, "but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract." [R. 587-588.]

On behalf of all of the defendants, he moved [R. 588-589] to dismiss the suit on the following grounds:

(a) Failure of jurisdiction because diversity of citizenship is lacking.

(b) The bar of the Statutes of Limitations.

Considerable evidence had been presented by both sides on the Limitations issue. This issue like that of the merits was also not reached, for the Judge (Honorable William C. Mathes) concluded:

(1) To change Warner's position in the suit from the defendant to complainant, align it as such and thereupon dismiss the First Cause of Action (in which United is a defendant) for failure of jurisdiction. [R. 79.]

(2) To dismiss the Second Cause of Action (in which United *is not* named a defendant for the reason that the controversy could not be determined without the presence

of United as a party[6] and consequently that cause was "without equity". [R. 79.]

In an opinion reported in 118 Fed. Supp. 781, Judge Mathes ruled:

(a) In a derivative suit brought in a Federal Court, the stockholders' corporation is alignable as a defendant if shown by preponderating proof to be actually dominated and controlled by the co-defendants; otherwise the corporation is to be aligned as a complainant.

(b) In the preliminary inquiry which the Court had ordered for the purpose of determining at the threshold, the presence of absence of jurisdiction, "neither the Warner corporation nor its Directors or Officers were shown to be at any time under the domination or control of the three brothers Warner" (*Id.* at p. 805); the brothers Warner were shown to have owned "less than 20%" of Warner stock; Warner directors to have exercised "their independent judgment", in good faith, when they considered and approved the Warner-United arrangement. (*Id.* at p. 804.)

(c) Therefore, Warner corporation must be realigned as a complainant with the consequence that diversity is destroyed and the Court rendered without power to proceed to hear the merits of the suit. (*Id.* at 805.)

The Court of Appeals "Affirmed as to the First Cause of Action. Reversed and remanded as to the Second." [R. 673.]

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[6]"No extended discussion is necessary to point out why a decree by this Court as to the Second Cause of Action without the presence of United before the Court would leave the controversy in such a condition that its final determination may be wholly inconsistent with equity and good conscience." (Opinion of the District Court, 118 Fed. Supp. at p. 810.)

ARGUMENT.

I.

There Is Neither Precedent nor Is There Valid Reason for Ruling That a Stockholder's Corporation Is Properly Aligned as a Defendant in a Derivative Suit, Only When Shown to Be "Dominated and Controlled" by the Co-defendants.

Stockholders' corporations in derivative suits have been traditionally aligned as defendants. And this Court has declined, repeatedly, to sanction their alignment otherwise than as defendants, inasmuch as corporate managements are (as Warner's is, in the case at bar) hostile to the objects of the suits; they oppose their being brought; they refuse to institute them; they are (as the Warner directorate admits it is) on the defendants' side of the matter in controversy—they uphold and defend as good and right, conduct which stockholder complainants charge is evil and wrong.

Time and again the Court has been urged to view stockholders' corporations as complainants: In *New Jersey v. Mills* (1884), 113 U. S. 249; in *Railroad v. Grayson* (1886), 119 U. S. 240; in *Doctor v. Harrington* (1905), 196 U. S. 579; in *Venner v. Great Northern Railroad* (1908), 209 U. S. 24. Contention in all these cases that this was the right of the matter centered in the argument that inasmuch as a victory for the stockholder in a derivative suit spells a victory for the corporation, the ultimate interests of the corporation are not in collision, but are rather equatable with those of the stockholder; *ergo* the corporation, like the stockholder, is a complainant and not a defendant.

The contention was rejected in each instance. In *New Jersey v. Mills, supra,* the Court declared the corporation

to be "rightly and necessarily a defendant" (113 U. S. at p. 256) and for the simple, logical and compelling reason that the corporation did not stand for what the complainant stood. It was obviously antagonistic and avowedly on the defendant's side of the matter in dispute. It united with the defendants (as did Warner in the case at Bar) "in defending the acts complained of and in denying the illegality and fraud charged against them." (*Id.* at p. 256.)

In *Railroad v. Grayson, supra,* the Court reiterated its position in the *Mills* case and observed that the suing stockholder "does not represent the company in its corporate capacity and has no authority to do so." (119 U. S. 240 at 244.) In bringing the suit, the stockholder is not suing for his corporation "but for himself." (*Id.* at 244.) This is so, notwithstanding the fact that a decree in his favor results in advantage to the company. "As a stockholder he is seeking protection from the illegal acts of his own company" (*id.* at 244) as well as the illegal conduct of others. And the Court again declined to view the corporation as a complainant and ruled that it was "rightly and necessarily a defendant." (*Id* at 243.)

There is not a word in the opinions of the *Mills* and *Grayson* cases, *supra,* to suggest that the managements of the corporations which were held to be properly aligned as defendants in those cases were under the "domination and control" of the co-defendants.[7]

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[7]"For 51 years since Doctor v. Harrington, supra, I have found no derivative stockholders' action in which the corporation was realigned as a plaintiff, as was done in Smith v. Sperling, supra, especially since there have been many stockholders' class actions where the complaints have even failed to allege antagonistic control and the corporation remains a defendant." Chief Judge Leahy in Gratz v. Murchison, 130 Fed. Supp. 709, 713-714 (D. Del. 1955).

And with deference to the courts below, we submit that neither in *Doctor v. Harrington,* 196 U. S. 579, nor in any other case has this court held "domination and control" of the corporation's directorate to be a prerequisite to maintaining a derivative suit in a Federal Court and naming the corporation as a defendant.

To the contrary, in *Delaware & Hudson v. Albany & Susquehanna,* 213 U. S. 435, 451, the Court indicated that there was no occasion to inquire into the good faith of the directors, for—"they might notwithstanding be firm in their views—firm to resist appeals against them. ". . . The attitude of the directors," Justice McKenna observed, "need not be sinister. It may be sincere. It was so in *Chicago v. Mills,* 204 U. S. 321, and *Ex parte Young,* 209 U. S. 123, and other cases. In this case it was certainly determined."

And see *Ashwander v. Tennessee Valley Authority* (1935), 297 U. S. 288, 319 in which the Court held that it is not incumbent upon a stockholder in a derivative suit ". . . to show that the managing board or trustees have acted *with fraudulent intent or under legal duress.*" Chief Justice Hughes went on to say,

> "The fact that the directors in the exercise of their judgment, either because they were disinclined to take a burdensome litigation *or for other reasons which they regarded as substantial* resolved to comply with legislative or administrative demands, has not been deemed an adequate ground for denying to the stockholders an opportunity to contest the validity of the governmental requirements to which the directors were submitting." (Emphasis added.)

Nor has this Court ever suggested that only when a stockholder's corporation in a derivative suit is alleged

and then proven to be "dominated and controlled" by the co-defendants, is it properly aligned as a defendant while one which is not alleged to be or if alleged to be, is not later proven to be so "dominated and controlled", is properly aligned as a complainant.

These concepts—they underlie the rulings of the Courts below[8]—are not only new to the whole body of judicial thinking on the subject, but they are decidedly at war with familiar doctrines governing alignment which this Court has voiced for some seventy years, for the guidance of bench and bar.

In case after case, this Court has pointed out that where the power to hear and determine the merits depends upon whether the matter in controversy is between citizens of different states, the Court will ascertain the real matter in dispute; (*Pacific R. R. v. Ketchum,* 101 U. S. 289-290) ascertain on which side each party is, really and genuinely; arrange the parties accordingly, (*Helm v. Zarecor,* 220 U. S. at 36) and then see whether all those that are on one side of the matter in dispute are citizens of states different from all those on the other side.

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[8]"It is hardly conceivable that the Court in the *Harrington* case (*Doctor v. Harrington, supra*) enjoined the trial court, on remand after the reversal therein, to entertain the action, even though it should be discovered as a matter of fact that, contrary to allegation, the corporation was not under disabling domination." Opinion of the Court of Appeals. [R. 670.] * * * "A great many of these cases have been decided upon the allegations of the pleadings. If the appropriate allegations are made in the complaint to show the corporation under domination of the individual defendants and the corporation depends upon the same grounds and with the same lawyers as the individual defendants, it is apparent that a prima facie case is made. But, when the trial is over, the court might well find that the corporation was never dominated, but was at all times a free and uncontrolled agency. When such facts are established uncontrovertibly, jurisdiction is at an end and the parties must be realigned." Opinion of the Court of Appeals. [R. 671.]

(*Indianapolis v. Chase Bank*, 314 U. S. 62, 69.) If they are, then the Court has the power to proceed to a hearing and determination on the merits. If not, the power is absent and the case must be dismissed.

In *Doctor v. Harrington*, 196 U. S. 579, the Court reversed the lower court which had apparently viewed favorably the contention that since the "ultimate interest of the corporation made defendant (was) the same as that of the stockholder made plaintiff". (*id.* at p. 587), it was right to realign the corporation as a plaintiff; thereby situate New York citizens on both sides of the litigation; and then dismiss the suit for failure of jurisdiction.

The court's grounds for reversing and restoring diversity and consequently jurisdiction were none other than (1) a stockholder who seeks protection from claimed unlawful conduct of his corporation and others, has a right to sue his company and to name it as a defendant[9] and (2) when such a suit is between citizens of different states, it may be brought in a Federal court. (*Id.* at p. 587.)

The court pointed out that it had always recognized such a stockholder's right to sue his company (*id.* at p. 588); that one of its Equity Rules, namely Rule 94,[10] contemplates and provides for a derivative suit which ex-

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[9]"A corporation is constituted, it is true, of all its stockholders but it has a legal existence separate from them—rights and obligations separate from them; and may have obligations to them. It can sue and be sued." (196 U. S. at 586.)

[10]"Every bill brought by one or more stockholders in a corporation, *against the corporation* and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since, by operation of law;

hibits stockholder and corporation on opposite sides of a controversy.

The court went on to observe (*id.* at p. 588) that the bill showed diversity of citizenship of the parties to be genuine—not simulated or fashioned collusively for the purpose of creating a case cognizable in a Federal court. It showed also, as required by the Rule, the efforts made by the stockholders to obtain redress from the company's "managing directors or trustees" and why these efforts failed: because the directorate was "under the absolute control and domination of the defendant, John J. Harrington and that said Harrington, by reason of having possession of a majority of the capital stock of said corporation" likewise controlled "the action of the stockholders"; and that Harrington had declined to redress the wrongs of which complaint was made. (196 U. S. at p. 588.)

In other words, these allegations of "domination and control" were not a jurisdictional *sine qua non;* their function was (as the Court pointed out in *Venner v. Gt. Northern, infra*, and *Delaware & H. v. Albany & Susquehanna, infra*) to exhibit to a Federal Court *which had jurisdiction* that the plaintiff had either complied with the requirements set forth in the Equity Rule 94 or had exhibited circumstances which excused such compliance.

In *Venner v. Gt. Northern* (1907), 209 U. S. 24, this Court again declined to regard the stockholder's corporation otherwise than as a defendant.

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and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action." (Emphasis added.)

In that case it was argued (seemingly as it was in the *Harrington* case) that the Circuit Court "was without jurisdiction and should have remanded it to the State Court for two reasons. First, because upon a proper alignment of the parties there was not a controversy between citizens of different states. Second, because the cause of action as disclosed by the pleadings showed that the Circuit Court had no jurisdiction over the subject matter" (209 U. S. at 31), *i. e.*, because the plaintiff had failed to comply with Equity Rule 94 in that "Whether or not he was a stockholder at the time when the alleged wrongful acts were committed by the defendants does not appear by any allegations in the complaint (*id.* at 29).

"These reasons," said Mr. Justice Moody, "are entirely independent of each other and require separate consideration. First was there a controversy between citizens of different states?" (*id.* at 31). Justice Moody went on to point out that while the Court may realign parties and place them "on the side where their interests in and attitude to the controversy really places them and then may determine the jurisdictional question in view of this alignment" (*id.* at 31-32) the fact that "it would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail" . . . . "is not enough" to warrant its being regarded other than as a defendant where (as in the case at Bar) the corporation admittedly "unites with the other defendants in resisting the plaintiff's claim of illegality and fraud"; where (as in the case at Bar) the defendants "are alleged to have engaged in the same illegal conduct and the injury is alleged to have been accomplished by their joint action." Under the circumstances, declared the Court, "the plaintiff's controversy is with both, and both are rightfully and necessarily made defendants and neither can, for jurisdictional

purposes, be regarded otherwise than as a defendant" (*id.* at p. 32, citing . . . *The Central Railroad Co. v. Mills*, 113 U. S. 249; *Railroad v. Grayson*, 119 U. S. 240; *Doctor v. Harrington*, 196 U. S. 579; *Groel v. Electric Co.*, 132 Fed. Rep. 252; *Chicago v. Mills*, 204 U. S. 321).

Coming to the second inquiry, namely, "Did the Circuit have jurisdiction of the subject matter of the litigation?", Mr. Justice Moody rejected the appellant's argument (*id.* at 33) "that a compliance with that rule [Rule 94] is essential to the jurisdiction" and said (*id.* at 34) "Neither the rule nor the decision from which it is derived* deals with the question of jurisdiction of the Courts, but only prescribes the manner in which jurisdiction shall be exercised." The learned Justice went on to point out "The objection that plaintiff has failed to comply with Equity Rule 94 may be raised by demurrer, but the admitted power to decide this question is also an admission that the Court has jurisdiction of the case." (*id.*, at 35.)

In *Delaware & Hudson v. Albany & Susquehanna* (1908), 213 U. S. 435, this Court had occasion to refer specifically to the allegations in the *Harrington* case with respect to "domination and control" and said of these allegations, that though their purpose was to show compliance with the requirement of Rule 94, their effect was "to show a case not of compliance with Rule 94, but circumstances which excused from such compliance." (213 U. S. at 449.)

Rule 94 is now incorporated in R. 23(b), F. R. C. P. In its present form the rule is declaratory of this Court's

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Hawes v. Oakland, 104 U. S. 450.

decisions in both *Hawes v. Oakland*, 104 U. S. 450, and *Delaware & Hudson v. Albany & Susquehanna, supra*, in that a plaintiff is now required to show either that he tried to get his corporation to remedy the wrong complained of or that such effort would be vain and futile. As pointed out in the Statement, *ante*, pp. 11-12, defendant's counsel in the case at bar stipulated that such efforts on the part of petitioner would have been futile. [R. 587.]

We submit that a fair evaluation of this Court's reflections in these cases warrants the conclusion that the Court has never held and that there is no valid reason for holding "domination and control" to be a prerequisite to aligning as a defendant a corporation whose directorate is opposed to the suit being brought; refuses to institute it; unites with the codefendants in resisting the stockholder's claim or otherwise manifests that it is on the defendants' side of the matter in controversy.

II.

The Warner Directorate Is, Avowedly, on the Defendants' Side of the Matter in Controversy. It Was Error to Realign the Corporation as a Complainant.

Only at the expense of "judicial integrity" (*Indianapolis v. Chase National Bank*, 314 U. S. 62 at 74,) may Warner be allied with the complainant, in face of directors' admissions (Statement, *ante*, pp. 6-7) which attest—to say the least[11]—that they are not on complainant's

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[11]Though found to be not "dominated and controlled" by the Warner brothers the Warner Board stands revealed, nevertheless, as a *sterilized* Board: for inherent in the directors' admissions are factors which tend, inexorably, to erode and destroy the stuff that directorial freedom is made of—the conciousness of being untrammelled, uninhibited in functioning for *all* the stockholders.

side of the dispute; in face of Warner counsel's concession [*ante*, p. 12, R. 587-588] that they are antagonistic to the suit; that the corporation is at one with the defendants in a common contention, viz.: the challenged dealings in which it and they participate, are lawful; and the Warner-United relationship which the stockholder prays the Court to terminate, should not be disturbed.

We contend it was error to align Warner as a complainant when the uncontroverted and admitted facts are—notwithstanding they are omitted from the District Court's findings—that the Warner directorate is on the defendants' side of the matter in controversy; and that it is not only "rooting," so to speak, for complainant's defeat but is definitely striving to bring it about. (*Indianapolis v. Chase Nat'l Bank, supra; Helm v. Zarecoor*, 220 U. S. 32, 36 (1911); *Pacific R. R. v. Ketchum*, 101 U. S. 289, 298 (1879); *Doctor v. Harrington*, 196 U. S. 579 (1904); *Venner v. Gt. Northern Ry.*, 209 U. S. 24, 32 (1907).)

The failure to make these important and, we submit, controlling facts the subject of findings derives, obviously, from the view held below that only "domination and control" by the co-defendants, proven "by a preponderance of the evidence"[12] warrants the alignment of the corporation as a defendant.

The error of both Courts below in realigning Warner Corporation as a complainant thus destroying diversity becomes clear when this Court's language in *Indianapolis v. Chase Nat'l Bank*, 341 U. S. (1941) 63, is adapted to the realities of the present case and it is seen that the question which "permeates this litigation" (*id.*, at 72)

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[12]Opinion of the District Court, 117 Fed. Supp. at 788.

is, should the Court terminate and cancel the Warner-United arrangement as unlawful and unfair to Warner and compel the co-defendants to account for injury they are alleged to have caused.

This is the "primary and controlling matter in dispute" (*id.*, at 72) with respect to which the complainant stockholder is admittedly on one side, and the Warner Corporation and the co-defendants are, by their own admission, indissolubly united on the other side. "Plainly, therefore," (*id.*, at 74) the Warner Corporation and the co-defendants "are, colloquially speaking, partners in litigation." What the complainant wants, the Warner Corporation and the co-defendants do not want. Yet by the decision of the Court below the complainant and the Warner Corporation were ranged alongside one another and "made to have a common interest" and objective when, in reality, they are opposed to each other and are poles apart in what they seek. "Therefore, if regard be had to jurisdictional integrity" the Warner Corporation and the co-defendants "are on the same side of the controversy not only for their own purposes but for purposes of diversity jurisdiction." (*id.*, at 74.)

Conclusion.

For the foregoing reasons, it is respectfully submitted that that portion of the judgment of the Court of Appeals which affirmed the judgment of the District Court should be reversed, and the case remanded to the Court of Appeals with directions to reverse the judgment of the District Court which dismissed the first cause of action for failure of jurisdiction and to remand the cause to the District Court with directions to try the merits of the controversy.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.

No. 316.

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

Brief of Respondents Warner Bros. Pictures, Inc., Jack L. Warner and Harry M. Warner in Opposition to Writ of Certiorari.

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SUBJECT INDEX

PAGE

The question presented 2

Statement of the case 2

Summary of argument in opposition to issuance of writ 5

Argument 6

Conclusion 15

Appendices:

Appendix I. Rules of Civil Procedure, Rule 23(b) ....App. p. 1

Appendix II. Rules of Civil Procedure, Rule 42(b) ....App. p. 2

TABLE OF AUTHORITIES CITED

CASES

	PAGE
Central Railroad of New Jersey v. Mills, 113 U. S. 249	8
Cutting v. Woodward, 255 Fed. 633	10
Delaware & Hudson Co. v. Albany & Susquehanna Railroad Co., 213 U. S. 435	8
Doctor v. Harrington, 196 U. S. 579	7, 8, 9, 10, 12, 13, 15
Hawes v. Oakland, 104 U. S. 50	9
Illinois Central Railroad v. Adams, 180 U. S. 28	9
Indianapolis v. Chase National Bank, 314 U. S. 63	6, 9, 13, 14
J. R. A. Corporation v. Boylan, 30 Fed. Supp. 393, aff'd 109 F. 2d 1018	10, 12
Koster v. American Lumbermen's Mutual Casualty Co., 330 U. S. 518	9, 12
Lavin v. Lavin, 182 F. 2d 870	10, 13
Railroad v. Grayson, 119 U. S. 240	8
Schmidt v. Esquire, 210 F. 2d 908	10, 11
Swanson v. Traer, 230 F. 2d 228	10, 13
Venner v. Great Northern Railway Co., 209 U. S. 24	7, 10, 12, 15

RULES

Equity Rule 94	3, 7, 8, 9
Rules of Civil Procedure, Rule 23(a)	5
Rules of Civil Procedure, Rule 23(b)	3, 6, 9, 14
Rules of Civil Procedure, Rule 42(b)	15

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Respondents.

Brief of Respondents Warner Bros. Pictures, Inc., Jack L. Warner and Harry M. Warner in Opposition to Writ of Certiorari.

The petitioner asks review of a decision of the Court of Appeals (Ninth Circuit) affirming a judgment of dismissal by the District Court rendered as to one count of a shareholder's derivative suit in which federal jurisdiction depended upon diversity of citizenship. By order of the District Court, the question of jurisdiction had been tried as a separate and preliminary issue. The trial thereon resulted in findings of fact made by the District Court which were reviewed by the Court of Appeals and found to be adequately supported by the evidence. Pursuant to the facts so found, the District Court determined that

Warner Bros. Pictures, Inc., the corporation on behalf of which the action was brought, though named in the complaint as a defendant, should, for the purposes of determining jurisdiction, be realigned as a plaintiff and that upon such realignment diversity no longer existed and hence there was no federal jurisdiction. The Court of Appeals reversed and remanded the case to the court below for further proceedings as to the second cause of action, which had been dismissed for lack of equity, and this does not appear to be herein involved.

The Question Presented.

We believe the case presents only one question and that is:

1. When facts are found after a trial, lasting more than fifteen days, which negate the corresponding allegations in the complaint, and which establish that the acts of the corporation were in good faith, without fraud, with no control or domination of its Board of Directors, or wrongful participation by any director, or officer, and that the corporation was not in the hands of anyone antagonistic to its interests, should the realignment of Warner Bros. Pictures, Inc. as a plaintiff, by the Trial Court be disturbed?

Statement of the Case.

The opinion of the Court of Appeals herein sets forth verbatim the findings of the District Court relating to the first cause of action [Pet. App. B, pp. 2-5; R. pp. 73-77]. The Court of Appeals examined the record and was satisfied that the findings were adequately supported. This is not a case, therefore, in which the allegations of a pleading must be accepted at face value but is one in which the realities of the controversy have been deter-

mined upon a lengthy trial, and full consideration of evidence reflected in a reporter's transcript nearly 2000 pages in length.

The complaint named Warner Bros. Pictures, Inc. as a defendant. It complains of the making of a motion picture production contract. It alleges that the plaintiff was the owner of 400 shares of stock from a time prior to the making of that contract [R. p. 4]; that the action was not collusive in order to confer jurisdiction [R. p. 3]; that demand upon the directors of the corporation to institute the action had not been made, but would be futile because all or a majority of the Board of Directors wrongfully participated in the acts complained of and because the Board was controlled by the active wrongdoers [Par. 24, R. p. 11]. These allegations together, that is to say Paragraphs 1, 4 and 24 of the complaint are obviously designed for the purpose of procedural compliance with Rule 23(b) (App. I) of the Rules of Civil Procedure (formerly Equity Rule 94).

Distinct from these assertions by way of formal compliance with the Rule, and to set forth the asserted grievance, the complaint alleges the making of a contract in 1945 between Warner Bros. Pictures, Inc. (Warner) and United States Pictures, Inc. (United) for the production of a substantial number of motion pictures over a number of years, such pictures to be made by United with partial or complete financing by Warner [Pars. 12 to 22 incl., R. pp. 5-10 incl.]. It alleges a conspiracy among the individual defendants to waste and divert the funds of Warner and enrich United and Sperling [Par. 11, R. p. 5] through the making of such contract and that the individual brothers Warner together owned a controlling block of the stock of Warner and controlled

and dominated the corporation, actively directed its policies and actions, including the acts complained of and did actually select, dominate and control the directors and officers of the corporation.

In contrast to such allegations, the facts as found after trial were that Warner was the real party in interest in the claim made [F. III, App. B, pp. 2-3]; that the Warner-United contract was made in good faith, without fraud, was considered by the Board of Directors to be a sound business arrangement for the best present and future interests of the corporation and intended to be a financial benefit to it; that the officers and Board of Warner acted in good faith and exercised their independent business judgment; that the Board of Warner consisted of eleven men, including the two individual brothers Warner named as defendant and a third brother not named as a defendant, all of whom together owned less than 20% of the outstanding stock; that neither the corporation nor the directors or officers were then or at any time under the domination or control of the brothers Warner, and that neither the stockholders, officers or directors were at any time antagonistic to the financial interests of the corporation [F. IV, App. B, pp. 3-4]. It was found that it was not true that any of the Board or officers of Warner wrongfully participated in the acts complained of and that if demand had been made upon the corporation to institute this action, the persons to whom such application would be made would not have been disqualified from faithfully doing their duties because of any matters set forth in the complaint or otherwise. It was found that the stockholders were not at any time or at all under the domination or control of the brothers Warner.

Summary of Argument in Opposition to Issuance of Writ.

1. The facts show the making of a contract by a corporation through its Board of Directors, eleven in number, which was in its line of business and regarded by the Board as a sound business arrangement; which was so made in the free and independent exercise of its duties and rights by such Board in good faith and without fraud; with no element of conspiracy, wrongdoing, control or domination by the individual defendants; with no invalidity by reason of statute or by-law or other claim of *ultra vires;* and with no control of the corporation antagonistic to its financial interests. Under these facts, the realities determined after trial required realignment of Warner for jurisdictional purposes as a plaintiff, after which diversity did not exist.

2. The question of jurisdiction and the question of compliance with Rule 23(a) are separate and distinct matters and whether or not the requirements of the Rule may be jurisdictional is not here involved. The decisions of this court cited in the argument deal with jurisdiction as such and not merely with procedure under rule, and where such decisions have resulted in a refusal to realign a corporate party for jurisdictional purposes, they have done so on the basis of allegations in the pleadings concerned or on the basis of facts found to be true showing the presence of fraud, control and domination, completely absent in the case at bar.

3. There is no conflict with the cited decisions of the Second or Seventh Circuits, and a very recent decision in the Seventh Circuit is in complete harmony.

4. The present decision of the Court of Appeals will not bar all future derivative suits from the federal courts,

but is a decision based upon facts found after trial on adequate evidence and the ruling thereon would not affect other cases in any way unless such other cases were based upon substantially equivalent facts.

Argument.

A.

The petition herein presents two questions (Pet. pp. 2-3), the first of which appears virtually moot since it is based on assertions of fact without consideration of the findings of the Trial Court on the issues covered thereby, and the second appears to question the power of a federal court to make realignment of a party with the consequent destruction of diversity. The power of a federal court to realign the parties for jurisdictional purposes is, we submit, beyond question and it is, in fact, the duty of the court to consider and determine their arrangement for such purposes.

Indianapolis v. Chase National Bank, 314 U. S. 63 at page 69.

B.

1. The petition here (p. 6) asserts that the present judgment is not supported by certain decisions of this court, but is in conflict with them, in that allegations or proven facts relating to domination and control do not relate to jurisdiction as such, but only to procedural compliance or non-compliance with former Equity Rule 94 (now Rule 23(b) of Rules of Civil Procedure). In the present case, petitioner, [Complaint, Par. 24, R. p. 11] and obviously because of the requirement of Rule 23(b), stated that no demand had been made upon the directors of the corporation and alleged as his reasons for not making such demand, applicable only to excuse

such failure, that at least a majority of the Board of Directors had wrongfully participated in the acts complained of and that the Board was controlled by the alleged miscreants. Irrespective of contrary findings, an allegation of reasons in the *complaint* is required by the Rule. However, in the body of the complaint, as already pointed out, and as a basis for the claim that the contract involved was wrongful and not merely to excuse demand, the complaint asserted conspiracy, control and domination of the corporation and its Board of Directors by the individuals. All of these allegations were completely negatived by the findings. Petitioner, we believe, confuses these elements in his own case and endeavors to interpret the decisions of this court accordingly.

Venner v. Great Northern Railway Co., 209 U. S. 24, makes clear the distinction and, following only three years after the decision in *Doctor v. Harrington*, 196 U. S. 579, is of value in analysis of the latter. In both, the question of jurisdiction was certified to this court. In the *Venner* case there were two elements, (1) jurisdiction as dependent upon diversity and (2) jurisdiction of the subject matter by reason of non-compliance with Equity Rule 94. The facts involved were those set forth in the complaint and not facts determined after proof. The allegations were that the Railway Company was under the absolute control and domination of the late James J. Hill and while in such position and exercising such control, he sold securities to it at a vast profit to himself. The complaint failed to comply with Rule 94 in that it did not allege the plaintiff to have been a stockholder at the critical times, *i. e.* the assertions of fraudulent domination and control were not a factor in the second question. This court said that alignment of parties in the position where their interest in and attitude

to the controversy should really place them, would still leave such parties as arranged by the pleader, because Hill and the corporation were alleged to have engaged in the same illegal and fraudulent conduct and the injury was brought about by their joint action, even though it might be for the financial interests of the corporation that the plaintiff should prevail. On this issue and not in connection with consideration of the effect of Rule 94, this court cites *Doctor v. Harrington* as precisely in point and, speaking of jurisdiction as such, notes that in the *Doctor* case, Harrington had directed the management of the affairs of the corporation, dictated the policy and selected the directors and that Harrington had fraudulently caused the corporation to act. This view of the *Doctor* case is that of this court and is the best comment thereon. In *Doctor v. Harrington* there was substantive compliance with the Rule and the question of formal compliance was not at issue, the single question certified to this court being a matter of jurisdiction based upon diversity.

Central Railroad of New Jersey v. Mills, 113 U. S. 249, and *Railroad v. Grayson,* 119 U. S. 240, are cited and discussed by petitioner, but neither touches the issue here. In each of those cases, the grievance alleged was an *ultra vires* act of the corporation, thereby giving rise to a real complaint by a stockholder against his own corporation. These two decisions differ basically from those cases involving a transaction in which the alleged vice is that it occurred while, and because, the corporation was under a disability due to improper domination by certain individuals.

In *Delaware & Hudson Co. v. Albany & Susquehanna Railroad Co.,* 213 U. S. 435, cited in the petition but not

by the Court of Appeals herein, the question certified to this court was whether failure to conform to Rule 94 prevented plaintiff from maintaining the suit. The opinion points out that in the *Doctor* case, there had not been formal, but had been practical compliance with the Rule in that the general facts alleged showed that it would have been futile to appeal to the Board for action. The matter was not one of realignment and *Doctor* showed that practical compliance with the Rule would permit maintenance of the suit.

Indianapolis v. Chase National Bank, 314 U. S. 63, would not ordinarily be described as a derivative suit though brought by a trustee on behalf of bond holders. It demonstrates that realignment may and should be made by the Federal Court whenever required, and that the power is not restricted to derivative suits by shareholders.

The very nature of a shareholder's derivative suit, as discussed in *Hawes v. Oakland*, 104 U. S. 50, brought about the formulation of Rule 94 and its successor Rule 23(b) requiring allegations to show that the nominal plaintiff was a proper person to set in motion the machinery of the court. A corporation is an entity which the complaining stockholder must show to be under some disability requiring that stockholder, as a self-appointed "next friend" or guardian, to bring suit on its behalf and for its benefit. This court has so described the relationship in *Koster v. American Lumbermens Mutual Casualty Co.*, 330 U. S. 518 at 522-523; and in *Illinois Central Railroad v. Adams*, 180 U. S. 28 at 34.

The disability asserted in such cases is usually, as here, that the corporation is so completely dominated by the individuals alleged to be miscreants that the corporation has no will of its own, but is practically the *alter ego* of

such miscreants. The *Venner* and *Doctor* cases, as well as *Cutting v. Woodward*, 255 Fed. 633, are examples of such disability attributed by allegation or proof to fraudulent domination and control. In the case at bar, these essentials were alleged, but at the trial they were proved untrue and the findings are to the contrary. The fiction must give way to the fact.

C.

Petitioner asserts that the decision here is in conflict with *J. R. A. Corporation v. Boylan*, 30 Fed. Supp. 393 (affirmed 109 F. 2d 1018), and *Lavin v. Lavin*, 182 F. 2d 870 in the 2nd Circuit and *Schmidt v. Esquire*, 210 F. 2d 908 in the 7th Circuit. The asserted conflict does not exist.

In contrast to the decisions cited in the petition, a very recent case in the 7th Circuit, *Swanson v. Traer*, 230 F. 2d 228, shows the complete harmony of that Circuit with the case at bar. The opinion therein cites and quotes from the opinion of the District Court herein, and reviews the same precedents as are herein involved. The Court of Appeals there affirmed a realignment of the corporation with resulting destruction of diversity. It does not cite or discuss *Schmidt v. Esquire* from its own Circuit, and this indicates, we submit, that the *Schmidt* case is not authority in the areas herein concerned, for the reasons hereinafter demonstrated. Furthermore, the opinion distinctly holds that a refusal by the Board of Directors to take action does not show antagonism, but merely a difference of opinion between the plaintiff and his corporation as to the wisdom of such action. It says that the test is whether there is a collision between the personal interests of those in control of the corporation (here the Board of Directors) and the interests of the corporation

in the subject matter of the suit. In the case at bar, the findings show there was no such collision as to require the retention of the corporation among the named defendants.

In the case at bar, the District Court expressed precisely the same thought and said (Pet. App. B, p. 46):

> "Patently, if difference of opinion were all the 'controversy' required to be shown between the stockholder and his corporation in order to preclude alignment of the latter with the plaintiff-stockholder, then there can be no occasion for all the pages of discussion of corporate domination or control, since every stockholder's derivative suit is by definition predicated upon the assumption that the corporation has refused to sue."

Schmidt v. Esquire, 210 F. 2d 908 (actually three cases) was a libel suit by a stockholder of the ill-fated Tucker Corporation against a number of publishers. In one suit, motion to remand had been made and denied because the court would not realign the Tucker Corporation as a plaintiff. On appeal, the 7th Circuit noted that it had not been the practice to realign such a corporation as a plaintiff merely because the action was one to enforce a corporate claim and recovery would be for the benefit of the corporation, but that the corporation would be left a defendant on the theory that it was controlled by antagonistic hands. This would seem to mean that there would be no realignment in such a case unless the *theory* of antagonistic control was overcome by the facts. The court remarks that a different rule of alignment would not be applied when there was no indication that the corporate management had refused to take action from fraudulent or other improper motives. These com-

ments of the court are actually dictum because it concluded that the citizenship of the Tucker Corporation was immaterial in any case, since it was in bankruptcy and a suit had not been authorized by the proper court. Even so, the dictum is correct in that it is not the refusal to take action on the part of the corporation or the reasons for that refusal which are relevant to realignment. The rule of alignment mentioned by the court is that established by *Koster, Venner* and *Doctor*.

In *J. R. A. Corporation v. Boylan*, 30 Fed. Supp. 393, the plaintiff corporation (New York), a stockholder in a New Jersey corporation, brought suit as such against the corporation and a number of its directors for waste. Many of the individual defendants were citizens of New York. In claiming diversity, the plaintiff apparently argued that under the state laws of New York the corporation and not the plaintiff was the *only* real plaintiff, and that, therefore, the citizenship of the actual plaintiff should be disregarded. If this were done, the New Jersey corporation would be the only party plaintiff, resulting in diversity between the New Jersey corporation and the individual directors, who were citizens of New York. The court said that it did not so interpret the rulings of the state courts of New York. Complete disregard of the citizenship of the actual party plaintiff would seem to be a unique idea, and unless this were done, realignment of the corporate defendant as a plaintiff would not have changed the situation so far as diversity is concerned. Clearly, the dismissal for lack of jurisdiction was correct. There was nothing parallel to the present case in any way and the mention of the *Doctor* and *Venner* cases in the decision itself does not assist this court in its analysis of its own decisions.

Lavin v. Lavin, 182 F. 2d 870, is again relevant only insofar as the court there comments on the *Doctor* case and indicates its view that the preferable rule would be that the corporate defendant should be automatically aligned as a plaintiff irrespective of assertions of domination or control if *Doctor* had not established an exception where there was antagonistic control, a view consonant with that of the Seventh Circuit in *Swanson v. Traer, supra,* where that court said realignment would be made unless the plaintiff could show facts to support allegations that the corporation was in antagonistic hands.

D.

Petitioner particularly claims error here in view of this court's decision in *Indianapolis v. Chase National Bank,* 314 U. S. 63. This case has already been mentioned and, of course it was not a shareholder's action. It does confirm the right and duty of a federal court to arrange the parties as they should be under the realities for the purpose of testing jurisdiction. In that case the true controversy was as to whether the assignee of a lease would be bound by its terms, and the asserted wrong lay in the refusal of the assignee to be so bound. The dispute, therefore, was between a lessor and an assignee of a lease on a question of law. This court ordered realignment with consequent failure of jurisdiction, because the actual plaintiff, a bondholder, and the lessor corporation were actually on the same side of the controversy. In the present case, absent all claim of fraud, lack of good faith or other misconduct or domination or control of Warner and absent all claim of *ultra vires* on the part of Warner under charter, by-laws or any statute, there is no controversy between the plaintiff and his corporation, as distinct from a controversy between the plaintiff and Warner on one side

and United on the other and realignment was required as in the *Indianapolis* case. The *Indianapolis* case, not being a shareholder's suit, was not subject to the requirements of Rule 23(b), which shows that the Rule has nothing to do with alignment, and by the same token, the position of the plaintiff therein did not involve the relationship of a shareholder to his own corporation.

E.

Petitioner, as his last point in requesting the issuance of a writ herein, urges that the matter is one of great importance in that if the present decision is allowed to stand, it will bar the federal courts to practically all derivative suits. The present case involves a specific application of rules many times considered by this court and other courts of appeal and does not present any new questions of principle. It is specificially based upon findings of fact set forth in full in the decision and could be a precedent only to the extent that those facts are substantially duplicated in some other action. As noted by the Court of Appeals herein, the petitioner cannot complain of a divergence of fact between his case and some other case in a different court; nor would any other plaintiff be affected if a divergence should exist. We submit it is improbable that any plaintiff in the future would *allege* facts duplicating the present proven facts, though after proof in such other suits there might well be substantial duplication, but if so, we submit it has been demonstrated herein the results should be the same, not necessarily on the basis of the present decision as a prece-

dent, but on the basis of a long line of decisions on the subject which are applied and reflected herein.

The opinion of the Court of Appeals herein suggests that there may be no reported precedent for the action of the Trial Court here in holding a trial of the facts relating to jurisdiction, separately and in advance of a full trial on the merits. (Pet. App. B, p. 8.) We submit no question arises because of such trial, since Rule 42(b), (App. II), cited by the court (Pet. App. B, p. 7), clearly permits isolation and separate trial of any issue, and the application of the Rule here was in the exercise of the soundest discretion, and in the best interests of the court and of all parties. The determination of the relevant facts on the trial, directly contrary to the corresponding allegations, is the factor requiring a result differing from the result in *Doctor* and *Venner*, for example, where the allegations alone were before the court, though the applicable rule is the same.

Conclusion.

The Court of Appeals epitomizes the general situation here in saying (Pet. App. B, p. 8):

> "It would be burdensome to the court and litigants if everyone were forced to accept allegations which all knew were false as a basis for jurisdiction and proceed to a long and expensive trial of the case, only to find by this arduous process that the allegations were untrue. Allegations are extremely easy to write. The tendency to abuse of stockholders derivative actions is too well known to require com-

ment. Once the facts are found, as here, proper realignment must be made and jurisdiction does not exist."

It is respectfully submitted that no showing has been made by the petitioner herein which would require the issuance of a writ.

Respectfully submitted,

EUGENE D. WILLIAMS,

Attorney for Respondents, H. M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc.

FRESTON & FILES,

RALPH E. LEWIS,

Of Counsel.

APPENDIX I.

Rule 23(b), Rules of Civil Procedure.

"In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refused to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularly the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

APPENDIX II.

Rule 42(b), Rules of Civil Procedure.

"The court in furtherance of convenience or to avoid prejudice may order a separate trial of any claim, cross-claim, counterclaim, or third-party claim, or of any separate issue or of any number of claims, cross-claims, counterclaim, third-party claims, or issues."

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IN THE

Supreme Court of the United States

October Term, 1956.

No. 316

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Ellis, Deceased,

Petitioner,

-vs-

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC.,

Respondents.

Brief of Respondents United States Pictures, Inc. and Milton Sperling in Opposition to Petition for Writ of Certiorari.

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> nation of who are plaintiffs and who are defendants. It is our duty, as it is that of the lower federal courts, to 'look beyond the pleadings and arrange the parties according to their sides in the dispute.' *Dawson v. Columbia Trust Co.*, 197 U. S. 178, 180." (*Indianapolis v. Chase National Bank, supra,* at p. 69.)

Accordingly, we submit that it is beyond question that the District Court in the instant case had the authority to realign Warners as a party plaintiff and to dismiss the action when federal diversity jurisdiction was thereby destroyed.

The other question presented by petitioner, namely: the propriety of realigning Warners as a party plaintiff in the present case, must likewise be resolved against petitioner in view of the findings of the District Court that neither Warners, its Board of Directors or stockholders were, at any time, dominated or controlled by anyone antagonistic to the financial interests of Warners in the subject matter of this suit, or otherwise. [Findings of Fact IV and V, R. pp. 75-77; Pet. App. B, pp. 3-4.]

The existence of such antagonism of interests by those in control of the corporation has been the only basis on which this Court has refused to align the corporate defendant in a shareholder's derivative action on the side of the plaintiff-shareholder instituting the action.

Doctor v. Harrington, 196 U. S. 579 (1905);

Venner v. Great Northern Railway Co., 209 U. S. 24 (1908);

Koster v. American Lumbermens Mutual Cas. Co., 330 U. S. 518 (1947).

The principle involved is succinctly stated in the *Koster* case, at page 523, as follows:

> ". . . But jurisdiction is saved in this class of cases (shareholder derivative actions) by a special dispensation because the corporation is in antagonistic hands. *Doctor v. Harrington*, 196 U. S. 579."

The petitioner argues that, to the extent that the *Doctor* and *Venner* decisions refer to the existence of domination and control of the corporation by antagonistic interests, they were concerned only with procedural compliance with former Equity Rule 94 (now Rule 23(b) of the Federal Rules of Civil Procedure), and not with the existence of federal diversity jurisdiction. We submit that those cases will not bear such interpretation.

In the *Doctor* case, the lower court realigned the defendant corporation on the side of the plaintiff-shareholder and dismissed the action on the ground that diversity jurisdiction was thus destroyed. The single question presented to this Court was whether federal diversity jurisdiction existed. This Court held that the corporation was properly a defendant in the action in view of the *allegations of the bill (no hearing or trial had been held)* that the defendant Harrington dominated and controlled the corporation.

This interpretation of the *Doctor* case is supported by the later decision in the *Venner* case, in which this Court considered, as separate and distinct issues (1) the question of diversity jurisdiction and (2) compliance with Equity Rule 94. The only facts before the Court were those *alleged in the bill.* It was alleged that the defendant James J. Hill exercised absolute domination and control over the corporation and, thereby, realized substantial

SUBJECT INDEX

PAGE

Question presented 2

Statement 3

Summary of argument 6

Argument 7

I.

The realignment of Warners as a party plaintiff was proper in view of the facts found by the District Court 7

II.

The decision of the Court of Appeals in the present case does not conflict with the decisions of any other courts of appeals 15

III.

The present case does not involve any new principles of law and its importance is limited to the specific facts on which it is based 17

Conclusion 18

Appendix I. Federal Rules of Civil Procedure, Rule 23(b) ..... App. p. 1

TABLE OF AUTHORITIES CITED

CASES

	PAGE
Central R.R. of New Jersey v. Mills, 113 U. S. 249	11, 12
Delaware & Hudson Co. v. Albany & Susquehanna Railroad Co., 213 U. S. 435	10, 11
Doctor v. Harrington, 196 U. S. 579	8, 9, 10, 11, 14, 16, 17, 18
East Tennessee, Virginia and Georgia R.R. Co. v. Grayson, 119 U. S. 240	12
Indianapolis v. Chase National Bank, 314 U. S. 63	7, 8, 13
J. R. A. Corporation v. Boylan, 30 Fed. Supp. 393, aff'd 109 F. 2d 1018	15, 16
Koster v. American Lumbermens Mutual Cas. Co., 330 U. S. 518	8, 9
Lavin v. Lavin, 182 F. 2d 870	15, 16
McNutt v. General Motors Acceptance Corporation, 298 U. S. 178	18
Niles-Bement Co. v. Iron Moulders Union, 254 U. S. 77	7
Schmidt v. Esquire, 210 F. 2d 908	15, 16
Swanson v. Traer, 230 F. 2d 228	15, 16
Venner v. Great Northern Railway Co., 209 U. S. 24	8, 9, 10, 11, 14, 16, 17, 18

RULES

Equity Rule 94	9, 10, 11
Federal Rules of Civil Procedure, Rule 23(b)	9, 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.

No. 316

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC.,

Respondents.

Brief of Respondents United States Pictures, Inc. and Milton Sperling in Opposition to Petition for Writ of Certiorari.

The petitioner seeks review by this Honorable Court of a decision of the United States Court of Appeals for the Ninth Circuit, which affirmed that portion of a judgment of the District Court dismissing the first cause of action of the complaint in a shareholder's derivative action ostensibly brought on behalf of Warner Bros. Pictures, Inc. (hereinafter sometimes referred to as "Warners"). Federal jurisdiction was based on alleged diversity of citizenship. The District Court ordered that questions relating to its jurisdiction be tried as separate and preliminary issues and, after an extensive trial thereof, the

District Court made findings of fact from which it concluded that Warners, though named as a defendant in the complaint, should properly be aligned as a party plaintiff in the action for the purpose of determining whether the requisite diversity of citizenship existed. Since, upon such realignment, there was not complete diversity of citizenship, the first cause of action was dismissed for lack of federal jurisdiction. The Court of Appeals reviewed the District Court's findings of fact, found that they were adequately supported by the record, and affirmed the judgment of dismissal of the first cause of action.

The District Court also dismissed the second cause of action of the complaint for want of equity on the ground that United States Pictures, Inc. (hereinafter sometimes referred to as "United"), named as a defendant in the first cause of action but not named as a party in the second cause of action, was an indispensable party to the second cause of action. The Court of Appeals reversed the judgment of dismissal as to the second cause of action and remanded the case to the District Court for further proceedings in relation thereto. However, the present petition does not appear to involve this portion of the Court of Appeals' decision.

Question Presented.

The sole question presented by this case is whether, for the purpose of determining if federal diversity jurisdiction exists in a shareholder's derivative action, it is error for the District Court to realign as a party plaintiff the corporation on whose behalf the action is ostensibly brought, and who is named as a defendant in the complaint, where, contrary to the allegations of the complaint, the District Court finds after an extensive trial of the

issues that: (1) the acts complained of were performed in good faith, without fraud and were considered by the Board of Directors of the corporation to be for the best interests of the corporation; (2) the directors of the corporation acted in good faith, in the exercise of their independent business judgment and without any domination or control being exerted over them; and (3) that the corporation was not, during any relevant period, in the hands or under the control of anyone antagonistic to the financial interests of the corporation.

Statement.

The present case is a typical shareholder's derivative action, brought by a shareholder of Warners ostensibly for the benefit of Warners. The plaintiff asserted two causes of action (a third cause of action was dismissed upon stipulation of the parties) but only the first cause of action, and the dismissal thereof by the court below, is involved in this petition.

By way of formal compliance with Rule 23(b), F. R. C. P., (Appendix I) the plaintiff alleged that he was the owner of 400 shares of stock of Warners from a time prior to the acts complained of [Complaint, par. 4; R. p. 4]; that the action was not a collusive one insofar as federal jurisdiction thereof is concerned [Complaint, par. 1; R. p. 3]; and the reasons for his not making any demand upon the directors of Warners to institute this action, to wit: that such demand would be futile because all or a majority of the Board of Directors, allegedly wrongfully participated in the acts complained of and that the Board of Directors was allegedly dominated and controlled by two of the individual defendants, Harry M. Warner and Jack L. Warner. [Complaint, par. 24; R. p. 11.]

Warners, a Delaware corporation, was named as a defendant in the first cause of action, together with United, also a Delaware corporation, Milton Sperling, president and a director and stockholder of United, and Harry M. and Jack L. Warner, officers, directors and stockholders of Warners; all of the individuals named as defendants were asserted to be citizens of California.

The transaction complained of by plaintiff was the making of a certain contract between Warners and United for the production of a number of motion pictures by United, which were to be partially or completely financed by Warners and distributed by Warners. [Complaint, pars. 12 to 22; R. pp. 5-10.] It was further alleged that the contract was made pursuant to a conspiracy among the individual defendants to waste and divert the funds of Warners and enrich United and Sperling [Complaint, par. 11; R. p. 5], and that the brothers Warner, through their ownership of a controlling block of stock in Warners, control and dominate Warners and select, dominate and control the directors and officers of Warners.

After a fifteen day preliminary trial on the jurisdictional issues, which is reflected in a reporter's transcript of nearly 2,000 pages, the District Court made findings of fact [R. pp. 73-77] negating the plaintiff's allegations of fraud and conspiracy and the domination and control of Warners by the individual defendants Harry M. and Jack L. Warner, or by anyone else. These findings of fact are set forth in full in the decision of the Court of Appeals (Pet. App. B, pp. 2-5), which held that such findings were adequately supported by the record.

Briefly stated, the District Court found: (1) that the Board of Warners consisted of eleven men, of whom

defendants Harry M. and Jack L. Warner, together with a third brother not named as a defendant, were but three members; (2) that at the time of the transaction complained of, the three brothers Warner owned, in the aggregate, less than 20% of Warners' outstanding stock; (3) that neither Warners, its stockholders, directors or officers were at any time under the domination or control of the brothers Warner; (4) that neither the stockholders, directors or officers were at any time antagonistic to the financial interests of Warners; (5) that the Warners-United contract in question was made and entered into in good faith and without fraud; and (6) that in approving and authorizing said contract, the officers and directors of Warners exercised their independent business judgment that such contract was a sound business arrangement for the best present and future interests of Warners and was intended by them to be of financial benefit to Warners and its stockholders.

The District Court also found that it was not true that any of the directors or officers of Warners wrongfully participated in the transactions complained of; and that it was not true that if demand had been made upon Warners to institute an action such as this, the persons to whom such application would be made would have been disqualified from faithfully performing their duty as officers or directors because of any matters or facts set forth in the complaint, or otherwise. The District Court expressly found that Warners was not at any time referred to in, hands or under control antagonistic to the financial interests of Warners or its stockholders.

On the basis of the foregoing findings, the District Court realigned Warners as a party plaintiff in the action and, since Warners, as a plaintiff, and United, as

a defendant, were both citizens of the State of Delaware, the requisite diversity of citizenship to confer federal jurisdiction did not exist as to the first cause of action. Accordingly, it was dismissed on that ground and such dismissal was affirmed by the Court of Appeals.

Summary of Argument.

I. The District Court was required to arrange the parties to the litigation according to their sides in the dispute and, after so arranging the parties, to determine whether the requisite diversity of citizenship existed to support federal jurisdiction. The District Court was not bound by the pleadings in making such determination and when it found, after a lengthy trial of the jurisdictional question, that Warners was not dominated or controlled by persons antagonistic to Warners' financial interests, the District Court properly concluded that Warners should be placed on the side of the plaintiff and the action dismissed since federal diversity jurisdiction did not exist.

II. The decisions of the United States Courts of Appeals for the Second and Seventh Circuits cited by petitioner are not in conflict with the instant decision of the Ninth Circuit and, in fact, a recent decision of the Seventh Circuit cites and follows the decision of the District Court in this action.

III. The decision of the Ninth Circuit is merely the specific application by it of existing decisions of this Honorable Court; it is based upon findings of fact made after trial of the jurisdictional issues and will not bar or otherwise affect federal jurisdiction in any future shareholder derivative actions except to the extent that the jurisdictional facts involved therein are substantially the same as those found to exist in the instant case.

ARGUMENT.

I.

The Realignment of Warners as a Party Plaintiff Was Proper in View of the Facts Found by the District Court.

The petition presents two questions for consideration by this Court, which may fairly be paraphrased as follows: first, did the lower court act properly, under the circumstance of this case, in realigning Warners as a party plaintiff; second, does a federal court have the power to realign the parties where the effect thereof is to destroy the diversity of citizenship of the parties (this latter question apparently being presented as a general question, independent of the particular facts of this case).

The second question must, logically, be dealt with first and it requires but little discussion. The decisions of this Court explicitly uphold the authority of the federal courts to inquire into the question of whether the parties are properly aligned in the proceeding and, if they are not properly aligned, to realign them according to their sides in the dispute and determine whether federal diversity jurisdiction exists based upon such realignment.

Indianapolis v. Chase National Bank, 314 U. S. 63 (1941);

Niles-Bement Co. v. Iron Moulders Union, 254 U. S. 77 (1920).

Not only has this Court upheld such power of the federal courts to determine whether federal jurisdiction of the action exists, but it has imposed a duty on the federal courts to make such inquiry:

". . . . Diversity jurisdiction cannot be conferred upon the federal courts by the parties' own determi-

personal profit from the sale of securities which he owned to the corporation.

The Court held that, even though the relief prayed for was for the financial benefit of the corporation, the facts alleged showed that the illegal conduct and injury complained of resulted from the joint action of the corporation and Hill and, therefore, made it proper to align the corporation as a party defendant for the purpose of determining federal diversity jurisdiction. The Court cited *Doctor v. Harrington,* as directly in point on this issue of alignment of the parties and, in discussing that case, points out that the defendant Harrington had there been held (on the basis of the allegations before the Court) to have dominated and controlled the corporation and fraudulently caused it to commit the acts complained of. The Court made no reference to the *Doctor* case in connection with its consideration of whether the plaintiff had complied with Equity Rule 94 in the *Venner* case.

Accordingly, petitioner's contention that the domination and control of the corporation by Harrington in the *Doctor* case was considered only in relation to the issue of whether the plaintiff therein complied with Equity Rule 94, is at complete variance with this Court's own interpretation of that case in *Venner v. Great Northern Railway Co.*

We recognize that allegations of domination and control of the corporation in a shareholder's derivative action are relevant to the issue of the plaintiff-shareholder's compliance with Equity Rule 94 (and its present counterpart in Rule 23(b), F. R. C. P.). As this Court held in *Delaware & Hudson Co. v. Albany & Susquehanna Railroad Co.,* 213 U. S. 435 (1909), such allegations are considered to be factors excusing the necessity of mak-

ing a demand upon the corporation to institute the action. However, they are most certainly also relevant to the question of proper alignment of the defendant corporation.

Although, as the petitioner points out, the *Delaware & Hudson* decision referred to *Doctor v. Harrington* in the context of its consideration of whether Equity Rule 94 had been complied with, there is no basis for inferring from the decision that the holding in *Doctor v. Harrington* was not on the point of federal diversity jurisdiction, which was the single issue before the Court in the *Doctor* case. Furthermore, the fact that the *Delaware & Hudson* case did not involve any question of realignment of the corporate defendant, negates any inference that the Court intended to abrogate the interpretation of *Doctor v. Harrington* set forth in the *Venner* case.

We submit that allegations of domination and control of the corporation in a shareholders derivative action are relevant both to formal compliance with the rules of procedure of the federal court (Equity Rule 94, Rule 23(b), F. R. C. P.) and to the question of the proper alignment of the defendant corporation. However, as to this latter point, *the question is not one of formal compliance with the rules but, rather, of the actual facts necessary to confer jurisdiction on the federal courts.* Where, as here, the actual facts are found to be that the corporation is not dominated or controlled by any one antagonistic to its financial interests in the subject matter of the suit, the principle set forth in the *Doctor, Venner* and *Koster* cases required the realignment of Warners as a party plaintiff.

Petitioner's reliance upon *Central R.R. of New Jersey v. Mills*. 113 U. S. 249 (1885) (cited by petitioner as *New Jersey v. Mills*) and *East Tennessee, Virginia and*

Georgia R.R. Co. v. Grayson, 119 U. S. 240 (1886) (cited by petitioner as *Railroca v. Grayson*) does not support his position. Neither of those cases were shareholder derivative actions. As appears from those decisions, they were each true class actions, brought by the shareholders of the corporations involved to set aside action taken by their respective corporations which, it was alleged, was *ultra vires.* In the *Mills* case the Court described the nature of the suit as follows:

> "The bill is filed by stockholders in the New Jersey Corporation, in behalf of themselves and other stockholders similarly situated, to set aside a lease made by that Corporation, acting in concert with the other defendants, of its railroad and property, in excess of its corporate powers and in fraud of the rights of the plaintiffs. All the defendants unite in defending the acts complained of and in denying the illegality and fraud charged against them. The New Jersey Corporation is in no sense a merely formal party to the suit, *or a party in the same interests with the plaintiffs;* but is rightly and necessarily made a defendant." (113 U. S. at p. 254.) (Emphasis added.)

And the *Grayson* opinion states "We are unable to distinguish this case from that of *N. J. Cent. R.R. Co. v. Mills,* 113 U. S. 249" (119 U. S. at p. 243).

Accordingly, as this Court held, there was no basis in those cases for aligning the corporations involved on the same side as the plaintiff-shareholders since the dispute was actually between the shareholders and their respective corporations; the actions were not brought for the ostensible benefit of the corporations involved, as is true in the case at bar. In fact, petitioner's own statements in his petition recognize this distinction (Pet. pp. 6-7).

Petitioner also contends that this Court's decision in *Indianapolis v. Chase National Bank, supra*, compels the conclusion that there was an actual controversy between petitioner and Warner as to whether this action should be instituted and that such controversy made it improper to align them on the same side.

The *Indianapolis* case was not a shareholders' derivative action. It was an action by a trustee under a trust indenture, brought on behalf of bondholders of a corporation, in which the trustee attempted to test the validity of a lease arrangement entered into by the corporation and the other defendants. The plaintiff joined the corporation as a party defendant and the issue before the court was whether the corporate defendant should be aligned on the side of plaintiff. As noted above, the Court in the *Indianapolis* case held that the parties should be aligned in accordance with the actualities of the dispute. Since the Court found that the actual controversy involved was between the corporation and the other defendants, and not between the trustee and the corporation, it ordered the trustee and the corporation to be aligned on the same side, resulting in a destruction of diversity jurisdiction.

In the present case there is also no dispute between the plaintiff and Warners except to the extent that Warners has differed with petitioner as to the institution of this action. However, as indicated in the decisions cited above, the question of the proper alignment of the corporation in a shareholder's derivative action depends upon whether the corporation is in the hands of persons antagonistic to its financial interests which prevent the corporation from asserting its rights, and not upon whether the shareholder and his corporation differ on the question of

whether to assert an alleged right of the corporation. As the District Court in the present case so aptly stated:

> "For a corporation to be 'in antagonistic hands' [Koster v. Lumbermens Mutual Co., *supra*, 330 U. S. at 523], or to have a 'hostile attitude' [Cutting v. Woodward, *supra*, 255 Fed. at 635] such as would permit alignment on the side against its presumptive financial interests, surely requires more than a mere argument or difference of opinion between the corporation and the suing stockholder as to the desirability of bringing the suit. Patently, if difference of opinion were all the 'controversy' required to be shown between the stockholder and his corporation in order to preclude alignment of the latter with the plaintiff-stockholder, then there can be no occasion for all the pages of discussion of corporate domination or control, since every stockholder's derivative suit is by definition predicated upon the assumption that the corporation has refused to sue." (Pet. App. B, pp. 45-46.)

We submit, therefore, that the decision in the present case is entirely consonant with the prior decisions of this Court on the question involved. The fact that the outcome in the *Doctor* and *Venner* cases was different from that in the present case was not caused by the application of different principles of law than the Court of Appeals here applied but, rather, resulted from the record before the Court in those cases indicating that the corporations there involved were under the control of persons antagonistic to the financial interests of such corporations. In the present case it was found *as a matter of fact*, after trial of the issues, that such antagonistic interests did not exist. Accordingly, the realignment of Warner as a party plaintiff was proper.

by Warners and distributed by Warners [Complaint, pars. 14 to 21; R. pp. 6-10].[2] It was further alleged that the contract was made pursuant to a conspiracy among the individual defendants to waste and divert the funds of Warners and to enrich United and Milton Sperling [Complaint, par. 11; R. p. 5], and that the brothers Warner, through their ownership of a large block of Warner stock, control and dominate Warners, and select, dominate and control the directors and officers of Warners [Complaint, par. 10; R. pp. 4-5].

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[2]The terms of the Warners-United contract in question can be briefly summarized as follows: The contract was made in September, 1945, and provided for the production by United of six motion pictures within a period of three years which were to be exclusively distributed by Warners [R. pp. 608, 615]. Warners and United were each to furnish 50% of the cost of production of each picture [R. p. 610]. For its services as distributor of the pictures, Warners was to receive 20% of the gross receipts from domestic distribution and 25% of the gross receipts from distribution in certain foreign countries, with a schedule of distribution rates to apply to distribution in other foreign countries [R. pp. 617-618]. After the deduction of the distribution fees as aforementioned, the proceeds from distribution of the pictures were to be applied toward the reimbursement of the parties for their costs and expenses in connection with the production of the pictures (Warners to recoup its production costs and expenses, including an allocable portion of its studio overhead, before United was to receive any such reimbursement), Warners was to be reimbursed for all distribution costs and expenses incurred by it, and the balance of such proceeds was to be divided equally between Warners and United [R. pp. 619-627].

The Warners-United Contract was amended in 1947, 1950, and 1952 to extend the term thereof and to provide for additional photoplays, as to which additional photoplays Warners would furnish 100% of the financing, but as to which Warners' distribution fees were increased to 25% of the gross receipts from domestic distribution and 30% of the gross receipts from distribution in certain foreign countries; the net proceeds from the distribution of the picture were to be divided between United and Warners on the basis of 80% to Warners, and 20% to United, instead of the equal division of net proceeds as provided in the 1945 agreement [R. pp. 653-655].

II.

The Decision of the Court of Appeals in the Present Case Does Not Conflict With the Decisions of Any Other Courts of Appeals.

Petitioner asserts, as a reason for granting the writ, that the decision in the present case is in conflict with *Schmidt v. Esquire*, 210 F. 2d 908 (7th Cir., 1954); *J. R. A. Corporation v. Boylan*, 30 Fed. Supp. 393 (S. D. N. Y.), affirmed, 109 F. 2d 1018 (2d Cir., 1940), and *Lavin v. Lavin*, 182 F. 2d 870 (2d Cir., 1950).

With respect to the Seventh Circuit's views on the question here involved, the very recent case of *Swanson v. Traer*, 230 F. 2d 228 (7th Cir., 1956), shows that it is in complete accord with the instant decision of the Ninth Circuit. In the *Swanson* case, the Court of Appeals affirmed the action of the District Court in realigning the corporation as a party plaintiff in a shareholder's derivative action, with consequent destruction of federal diversity jurisdiction. It cites and quotes from the opinion of the District Court herein, reviews the same precedents as are here involved and reaches the same result as in the case at bar. It holds that the refusal of the board of directors of the corporation to institute the action upon request of the plaintiff-shareholder does not show an antagonism of interests, but merely a difference of opinion between the shareholder and his corporation as to the wisdom of bringing the action. The opinion states that, in order to prevent the realignment of the corporation as a party plaintiff, it must appear that there is a collision between the personal interests of those in control of the corporation and the interests of the corporation in the subject matter of the suit. In the present case, the findings expressly negate any such collision of interests.

Answers were filed by United and Milton Sperling [R. pp. 16-20] and by Warners and the brothers Warner [R. pp. 20-26].

When the case came on for trial, the District Court, determining that the pleadings raised a question as to the court's jurisdiction, ordered the jurisdictional issue to be tried first, together with the issue of whether the action was barred by the statute of limitations, and the parties were ordered to present evidence only as to those two issues in advance of the trial of the other issues in the case [R. p. 72].

After a fifteen day preliminary trial on these issues, which is reflected in a reporter's transcript of nearly 2000 pages, the District Court made findings of fact negating plaintiff's allegations of fraud and conspiracy and the domination and control of Warners by the individual defendants, Harry M. and Jack L. Warner, or by anyone else [Findings of Fact IV and V; R. pp. 74-77]. These findings of fact were reviewed by the Court of Appeals which held that such findings were adequately supported by the record [R. p. 669].

Briefly stated, the pertinent findings of the District Court are as follows: (1) That the Board of Warners consisted of eleven men, of whom defendants Harry M. and Jack L. Warner, together with their brother, Albert Warner, who was not named as a defendant, were but three members; (2) that at the time of the transaction complained of, the three brothers Warner owned, in the aggregate, less than 20% of Warners' outstanding stock;[3]

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[3]Actually, the three brothers Warner owned only approximately 15% of Warners' outstanding stock. [Stipulation of Facts, R. p. 28.]

In view of the *Swanson* case, there is no reason to discuss the earlier decision of the Seventh Circuit in *Schmidt v. Esquire, supra,* which was neither cited nor referred to in the *Swanson* opinion. However, it should be noted that the only comments in the *Schmidt* case on the point here involved was by way of dictum, and was not material to the decision there reached.

The decisions of the Second Circuit cited by petitioner are clearly distinguishable from the present case.

J. R. A. Corporation v. Boylan, supra, was a shareholder's derivative action brought by a New York citizen on behalf of a New Jersey corporation, against a number of the directors of the corporation many of whom were also New York citizens. Unlike the present case, the plaintiff in the *Boylan* case argued that the corporation should be aligned as a party plaintiff and, since it was actually the only real party in interest, the citizenship of the plaintiff-stockholder should be ignored in determining whether there was diversity of citizenship. The Court rejected this novel proposition of disregarding the citizenship of the actual plaintiff and dismissed the action for want of jurisdiction. Although the Court cited the *Doctor* and *Venner* cases, it is obvious that the *Boylan* decision is in no sense parallel or similar to the present case.

In *Lavin v. Lavin, supra,* the plaintiff shareholder and the corporation for whose benefit the suit was brought were both New York citizens, and, as in the *Boylan* case, the plaintiff apparently contended that the corporation should be aligned as a party plaintiff. The Second Circuit refused to order such a realignment on the basis of the decision in *Doctor v. Harrington.* The Court said that it thought the preferable rule would be automatically to align the defendant corporation as a party plaintiff ir-

(3) that neither Warners, its directors or officers were at any time under the domination or control of the three brothers Warner; (4) that neither the stockholders, directors or officers were, at any time involved in this action, antagonistic to the financial interests of Warners; (5) that the Warners-United contract in question was made and entered into in good faith and without fraud; (6) that in approving and authorizing the Warners-United contract, the officers and directors of Warners, in the exercise of their independent business judgment, considered the contract to be a sound business arrangement for the best present and future interests of Warners and was intended by them to be of financial benefit to Warners and its stockholders; (7) that it was not true that any of the directors or officers of Warners wrongfully participated in the transactions complained of, and (8) that it was not true that had demand been made upon Warners to institute an action such as this, the persons to whom such application would be made would have been disqualified from faithfully performing their duties as officers or directors because of any matter or facts set forth in the complaint or otherwise.

The District Court further expressly found that Warners was not, at any time referred to, in hands or under control antagonistic to the financial interests of Warners or its stockholders [R. pp. 76-77].

On the basis of the foregoing findings, the District Court realigned Warners as a party plaintiff in the action and since Warners, as a plaintiff, and United, as a defendant, were both citizens of the state of Delaware, the requisite diversity of citizenship did not exist as to the first cause of action of the complaint. Accordingly, the

respective of assertions of domination or control, but that the *Doctor* case had established a different rule where *antagonistic control of the corporation existed.* This view is, of course, perfectly consistent with the decision in the case at bar, the difference in result arising out of the fact that Warners was not controlled by anyone antagonistic to its interests.

III.

The Present Case Does Not Involve Any New Principles of Law and Its Importance Is Limited to the Specific Facts on Which It Is Based.

Petitioner contends that this Court should review the present case because it involves important issues which, unless resolved in favor of petitioner, will bar shareholders from invoking the jurisdiction of federal courts in derivative actions. We submit that no such widespread effect can be attributed to the case at bar.

The decision of the Court of Appeals herein involves merely the application of the long-standing principles of the *Doctor* and *Venner* cases to a specific fact situation. If and when the fact situation presented in this case is substantially duplicated in any future shareholder derivative action, whether arising in a federal court in the Ninth Circuit or in any other federal court, we believe the same result should be reached as was reached herein. However, the reason for this is not that the present case establishes a new precedent; on the contrary, the decision in the present case is based upon numerous precedents established by decisions of this Court and of other courts which have considered the question here involved.

It may be true, as suggested by the Court of Appeals, that the trial of the jurisdictional issue here involved as

first cause of action was dismissed on that ground[4] and such dismissal was affirmed by the Circuit Court of Appeals.

Much of Petitioner's Statement (Pet. Br. pp. 6-12) purports to set forth certain of the evidence before the District Court together with Petitioner's inferences and conclusions therefrom. Presumably, Petitioner has included this material in an effort to detract from the findings made by the District Court. Petitioner contended in the Court of Appeals that the findings were not supported by the evidence, but, as noted above, the Court of Appeals rejected this argument and specifically upheld the District Court's findings [R. p. 669]. We are confident that this Court would likewise reach the same conclusion as to the findings if it were to review the record.[5]

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[4]The District Court did not pass on the issue of whether the action was barred by the statute of limitations in view of its determination that federal jurisdiction was lacking.

[5]The evidence in the record to support the District Court's findings included the following: At the meeting of Warners' Board of Directors at which the Warners-United contract was approved, the individual defendants Harry M. and Jack L. Warner were not present [Pltf. Ex. 18, R. p. 605]. Of the seven directors who were at the meeting, six testified by deposition and one, Friedman, testified in person at the trial. Friedman testified that he had made an analysis of the Warners-United contract and presented this analysis to the Board of Directors at the time it approved the contract [R. pp. 453-455]. Friedman further testified that no one had suggested or requested him to vote in favor of the contract and that his vote in favor thereof was arrived at independently [R. p. 458]. Director Catchings, who had no connection with Warners except in his capacity as a Board member [R. pp. 245-246], testified that he had voted in favor of the contract in the exercise of his independent business judgment and because he thought it was a good contract for Warners to have from a business viewpoint [R. pp. 247-249, 254, 257]. Director Guggenheimer, an attorney, testified that he had voted for the contract in the exercise of his independent business judgment and that no one had directly or indirectly attempted to indicate how he should vote on the issue [R. pp. 273-276], and

a separate and preliminary question was a novel procedure. Nevertheless, such procedure conforms to the general principle that a court can and should inquire into the validity of jurisdictional allegations at any stage of the proceedings.

McNutt v. General Motors Acceptance Corporation, 298 U. S. 178, 189 (1936).

However, we do not understand the petitioner to complain about the time of the trial of the jurisdictional issue. Rather, his complaint is that the findings of fact contradict the allegations which he made as to jurisdiction. In order to overcome the deficiency in the evidence adduced by him at the trial, petitioner would have this Court discard the established principles of the *Doctor* and *Venner* cases and adopt a new principle of law applicable to derivative actions, whereby plaintiffs, in the position of petitioner, would be guaranteed a trial on the merits in a federal court without regard to whether there was any justification for disregarding the status of the corporate defendant as the real party in interest in the litigation.

Conclusion.

It is respectfully submitted that no showing has been made by the petitioner herein which entitles petitioner to the issuance of the writ.

Respectfully submitted,

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However, the Petition for the Writ of Certiorari did not raise any question as to the adequacy of the evidence to support the findings and, under the rules of this Court,[6] the Petitioner should not now be permitted to raise any such issue.

Furthermore, at most the Petitioner has presented details of evidence (to the extent that such evidence can be identified separately from Petitioner's inferences and conclusions therefrom and his characterizations thereof)

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director Wolf gave similar testimony with respect to his decision and vote [R. pp. 287-290]. The other directors each testified that their action, in voting in favor of the contract, was also taken based upon their independent judgment and without any influence being exerted upon them [Carlisle, R. pp. 177, 182, 187-188; Perkins, R. pp. 297-298, 300, 304; Albert Warner, R. pp. 237, 239-240].

Director Friedman testified that he did not consider that the three brothers Warner had either actual or working control of Warners by virtue of their stockholdings in the company [R. pp. 490-491]. Director Catchings testified that the brothers Warner did not indicate or otherwise attempt to force on the Board of Directors the selections of the brothers Warner for membership on the Board [R. pp. 261-263].

There was also evidence that the Warners-United contract was in the normal line of Warners' business and that many of the basic provisions thereof were the same as those formulated by the legal department of Warners for use in other independent production-distribution arrangements to which Warners was a party, and that the contract involved was largely based upon a form of agreement between Warners and another independent producer, Michael Curtiz Productions [R. pp. 408-409].

At the time of trial, eight pictures had been made by United under the agreement and, even though some had not yet run their course of full distribution, all but one had been profitable [see Deft. Ex. B-2-A, R. p. 660]. The financial benefits to Warners from the pictures produced by United under the agreement, as compared with those of other independent producers whose pictures were distributed by Warners, were excellent [Deft. Ex. B-3-A, R. p. 661]. There was also testimony that Warners could expect to receive benefits under the contract, including its distribution fees, in excess of $11,000,000 [R. pp. 528-529].

[6]Supreme Court Rule 40.1(d)(2).

APPENDIX I.

Rule 23(b), Federal Rules of Civil Procedure.

"In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

which he, apparently, believes conflict with the findings of the District Court. This Court has repeatedly said that it will not review a conflict of evidence or assess the weight or preponderance thereof. (See, *e.g.*, *N. L. R. B. v. Pittsburgh Steamship Co.*, 340 U. S. 498 at 503 (1951).) For the above reasons, we have not deemed it necessary to take issue with the numerous unjustified inferences and conclusions from the evidence set forth in Petitioner's Statement and elsewhere in his brief.

However, we must take issue with the statements of Petitioner that counsel for Warners, at the close of the trial, "*admitted* that stockholder and corporation are at odds and occupy opposing positions in the controversy over the legality of the Warner-United relationship" and conceded that Warners "was not on the complainant's but on the defendants' side of the matter in controversy" (Pet. Br. pp. 11-12). Petitioner refers to pages 587-588 of the Record to support these statements, where a colloquy between the District Court and Warners' counsel is reported. We submit that all that can be fairly inferred from the colloquy referred to is that Warners' counsel conceded that if the plaintiff had made a demand upon Warners' Board of Directors to bring this suit, the suit would not have been brought ". . . but not for the reason alleged in the complaint that there was domination; but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract." [R. p. 588.]

Summary of Argument.

I.

The federal courts are required to arrange the parties to the litigation according to their sides in the primary and controlling matter in dispute and, after so arranging the parties, to determine whether the requisite diversity of citizenship existed to support federal jurisdiction of the action.

II.

The rules of decision of this Court require that the corporate defendant in a shareholder's derivative action be aligned as a party-plaintiff in the litigation where, as in the present case, it is determined that the corporation was not dominated or controlled by persons antagonistic to the corporation's financial interests in the subject matter of the litigation.

III.

Disagreement between a shareholder and the responsible officers and directors of his corporation as to the wisdom of asserting a cause of action which the shareholder contends the corporation has, does not give rise to such "antagonism of interest" so as to require the corporation to be aligned as a party-defendant in a derivative action brought by the shareholder to enforce the alleged cause of action, where, as in the present case, such officers and directors are found to be *not* antagonistic to the financial interests of the corporation in the subject matter of the litigation and *are* found to be acting in good faith and free from legal duress.

ARGUMENT.

I.

The District Court Was Both Empowered and Required to Determine Whether the Requisite Diversity of Citizenship to Support Federal Jurisdiction Existed, and, for That Purpose, to Inquire Into the Jurisdictional Facts Necessary to Determine the Proper Alignment of the Parties.

The existence of the requisite diversity of citizenship to support federal jurisdiction is dependent upon the proper alignment of the parties in the action.

Indianapolis v. Chase National Bank, 314 U. S. 63 (1941);

Niles-Bement-Pond Co. v. Iron Moulders Union, 254 U. S. 77 (1920).

As in the case of any other jurisdictional fact, the District Court was not bound by the pleadings and the burden was upon the Petitioner, since he invoked the jurisdiction of the federal court, to prove the facts necessary to sustain federal jurisdiction.

Dawson v. Columbia Ave. Sav. Fund, S. D. Title & T. Co., 197 U. S. 178 (1905);

Gilbert v. David, 235 U. S. 561 (1915);

McNutt v. G. M. A. C., 298 U. S. 178 (1936);

KVOS, Inc. v. Associated Press, 299 U. S. 269 (1936).

The District Court was required to determine whether the parties were properly aligned according to their sides with respect to the primary and controlling matter in dispute, and, when it found that they were not properly aligned, to realign them and to determine whether federal

diversity jurisdiction existed based upon such realignment. The extent of the District Court's duty in this respect, and the principles involved, are succinctly stated by Mr. Justice Frankfurter in *Indianapolis v. Chase National Bank, supra,* as follows:

> "Though variously expressed in the decisions, the governing principles are clear. To sustain diversity jurisdiction there must exist an 'actual,' *Helm v. Zarecor,* 222 U. S. 32, 36, 'substantial,' *Niles-Bement-Pond. Co. v. Iron Moulders Union,* 254 U. S. 77, 80, controversy between citizens of different states, all of whom on one side of the controversy are citizens of different states from all parties on the other side. *Strawbridge v. Curtiss,* 3 Cranch 267. Diversity jurisdiction cannot be conferred upon the federal courts by the parties' own determination of who are plaintiffs and who defendants. It is our duty, as it is that of the lower federal courts, to 'look beyond the pleadings and arrange the parties according to their sides in the dispute.' *Dawson v. Columbia Ave. Sav. Fund, S. D. Title & T. Co.,* 197 U. S. 178, 180. Litigation is the pursuit of practical ends, not a game of chess. Whether the necessary 'collision of interests,' *Dawson v. Columbia Ave. Sav. Fund, S. D. Title & T. Co., supra,* at 181, exists, is therefore not to be determined by mechanical rules. It must be ascertained from the 'principal purpose of the suit,' *East Tennessee V. & G. R. v. Grayson,* 119 U. S. 240, 244, and the 'primary and controlling matter in dispute,' *Merchants' Cotton Press & Storage Co. v. Insurance Co. of N. A.,* 151 U. S. 368, 385. These familiar doctrines governing the alignment of parties for purposes of determining diversity of citizenship has consistently guided the lower federal courts and this Court." (Pp. 69-70.)

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IN THE

Supreme Court of the United States

October Term, 1956

No. 316

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF OF RESPONDENTS UNITED STATES PICTURES, INC. AND MILTON SPERLING.

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In the present case, the District Court followed the principles enunciated in the aforementioned cases, conducted an extensive trial of the jurisdictional issues, and, based upon the evidence thereby disclosed, determined that Warners should be aligned on the side of the plaintiff. Since this resulted in there being a Delaware cititzen as a plaintiff (Warners) and a Delaware citizen as a defendant (United), the court properly dismissed the action for lack of diversity of citizenship.

The Petitioner appears to concede the principles enunciated in *Indianapolis v. Chase National Bank, supra,* but he advances the theory that Warners, on whose behalf and in whose interests he purports to act, should be aligned as a defendant in the action because he and Warners' Board of Directors differ on the question of whether it is in the interests of Warners to bring this suit.[7]

The fallacy in this theory is evident when it is recognized that the long established principles of equity (now embodied in Rule 23(b), F. R. C. P.) require, as a condition precedent to the institution of a derivative action by a shareholder, that the corporation on whose behalf the suit is ostensibly brought refuses to bring such action itself. Accordingly, under Petitioner's theory, no question as to the proper alignment of the corporate defendant could ever arise since, in order for the shareholder to

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[7]In this connection, it should be noted, as pointed out above, that the District Court found that the members of Warners' Board considered the Warners-United contract to be a sound business arrangement for the best present and future interests of Warners [Finding of Fact IV, R. p. 75], and that the evidence showed that the projected benefits to Warners under the contract would exceed $11,000,000 [Testimony of S. Schneider, vice-president and director, R. p. 529].

SUBJECT INDEX

PAGE

Question presented 1

Statement 2

Summary of argument 10

Argument 11

I.

The District Court was both empowered and required to determine whether the requisite diversity of citizenship to support federal jurisdiction existed, and, for that purpose, to inquire into the jurisdictional facts necessary to determine the proper alignment of the parties 11

II.

Warners was properly realigned as a party-plaintiff in view of the facts found by the District Court 15

III.

Disagreement between petitioner and Warners' Board of Directors as to the wisdom of instituting this litigation does not require or permit Warners to be aligned as a party defendant in determining the existence of federal diversity jurisdiction 26

Conclusion 30

TABLE OF AUTHORITIES CITED

CASES

	PAGE
Ashley v. Keith Oil Co., 73 Fed. Supp. 37	29
Ashwander v. Tennessee Valley Authority, 297 U. S. 288	25
Central R.R. Co. of New Jersey v. Mills, 113 U. S. 249	22, 23, 24
Cohen v. Beneficial Industrial Loan Corp., 337 U. S. 541	28
Dawson v. Columbia Ave. Sav. Fund, S. D. Title & T. Co., 197 U. S. 178	11
Delaware & Hudson Co. v. Albany and Susquehanna R. Co., 213 U. S. 435	21
Doctor v. Harrington, 196 U. S. 579	14, 15, 16, 17, 18, 19, 20, 21, 22, 25, 29
East Tennessee, Virginia and Georgia R. R. Co. v. Grayson, 119 U. S. 241	22, 23, 24
Gilbert v. David, 235 U. S. 561	11
Indianapolis v. Chase National Bank, 314 U. S. 63	11, 12, 13, 27, 28
Koster v. American Lumbermens Mutual Cas. Co., 330 U. S. 518	14, 15, 16, 17, 18, 21, 22, 29
KVOS, Inc. v. Associated Press, 299 U. S. 269	11
Lavin v. Lavin, 182 F. 2d 870	14, 29
McNutt v. G. M. A. C., 298 U. S. 178	11
National Labor Relations Board v. Pittsburgh Steamship Co., 340 U. S. 498	9
Niles-Bement-Pond Co. v. Iron Moulders Union, 254 U. S. 77	11
Venner v. Great Northern Railway Co., 209 U. S. 24	14, 15, 16, 17, 18, 19, 20, 21, 22, 25, 29

RULES

Equity Rule 94	18, 19, 20, 21
Federal Rules of Civil Procedure, Rule 17(a)	16
Federal Rules of Civil Procedure, Rule 23(b)	3, 13, 18, 21, 22
Rules of the United States Supreme Court, Rule 40.1(d)(2)	8

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF OF RESPONDENTS UNITED STATES PICTURES, INC. AND MILTON SPERLING.

Question Presented.

The sole question presented by this case is whether, for the purpose of determining if federal diversity jurisdiction existed in a shareholder's derivative action, it was error for the District Court to realign as a party-plaintiff the corporation on whose behalf the action is ostensibly brought, but who was named as a defendant in the complaint, where:

(A) The District Court held a preliminary trial of the issue of jurisdiction; and

(B) The District Court found, contrary to the allegations of the complaint: (1) that the acts complained of were performed in good faith, without fraud, and were considered by the Board of Directors of the corporation to be for the best present and future interests of the corporation; (2) that the directors of the corporation in fact acted in good faith, in the exercise of their independent business judgment and without any domination or control being exerted over them at the time of the transaction complained of or at any other time referred to; (3) that the corporation was not, at any time referred to, in the hands or under the control of anyone antagonistic to the financial interests of the corporation; and (4) that the directors and officers of the corporation were in no way disqualified from enforcing the corporation's rights.

Statement.

The present case is a typical shareholder's derivative action, brought by a shareholder of Warner Bros. Pictures, Inc. (hereinafter for convenience referred to as "Warners") ostensibly for the benefit of Warners. The plaintiff asserted two causes of action (a third cause of action alleged in the complaint was dismissed upon stipulation of the parties) but only the first cause of action, and the dismissal thereof by the court below, is involved in this petition.[1]

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[1]Neither defendant United States Pictures, Inc. nor defendant Milton Sperling were named as parties to the second cause of action.

By way of formal compliance with Rule 23(b), Federal Rules of Civil Procedure, the plaintiff alleged in his complaint that the action was not a collusive one insofar as federal jurisdiction thereof is concerned [Complaint, par. 1; R. p. 3]; that he was the owner of 400 shares of stock of Warners from a time prior to the acts complained of [Complaint, par. 4; R. p. 4]; and the reasons for plaintiff's failure to make any demand upon the directors of Warners to institute this action, to wit: that such demand would be futile because all or a majority of the Board of Directors allegedly wrongfully participated in the acts complained of and that the Board of Directors was allegedly dominated and controlled by two of the individual defendants, Harry M. Warner and Jack L. Warner [Complaint, par. 24; R. p. 11].

Warners, a Delaware corporation, was named as a defendant in the first cause of action, together with United States Pictures, Inc. (hereinafter called "United"), also a Delaware corporation, Milton Sperling, president and a director and stockholder of United, and Harry M. and Jack L. Warner, officers, directors and stockholders of Warners; all of the individuals named as defendants were asserted to be citizens of the State of California. Federal jurisdiction was alleged to be based on diversity of citizenship of the parties.

The transaction complained of by plaintiff was the making of a certain contract between Warners and United for the production of a number of motion pictures by United, which were to be partially or completely financed

the only facts before the Court were those alleged in the bill. It was alleged that the defendant, James J. Hill, exercised absolute domination and control over the corporation and, thereby, realized substantial personal profits from the sale to the corporation of securities which he personally owned.

The Court, noting the above facts, held that even though the relief prayed for was for the financial benefit of the corporation, the facts alleged showed that the illegal conduct and injury complained of resulted from the joint action of the corporation and Hill, that Hill dominated and controlled the corporation, and, therefore, it was proper to align the corporation as a party-defendant for the purpose of determining federal diversity jurisdiction. The Court said:

> "The case of *Doctor v. Harrington* is directly in point on this branch of the case and is conclusive." (209 U. S. at p. 32.)

With respect to the other and separate issue before the Court in the *Venner* case, namely, whether the complainant had complied with Equity Rule 94, the Court merely noted in its consideration of this branch of the case that the "plaintiff in *Doctor v. Harrington* complied with the requirement of the rule" (209 U. S. at p. 33).

Accordingly, we submit that Petitioner's contention that the domination and control of the corporation by defendant Harrington in the *Doctor* case was considered only in relation to the issue of whether the complainant therein complied with Equity Rule 94, is at complete variance not only with the opinion in the *Doctor* case, but also with this Court's own interpretation of the *Doctor* case, in *Venner v. Great Northern Railway Co.*

In addition, and by way of absolute refutation of Petitioner's attempt to restrict the application of the *Doctor* case to the question of compliance with Equity Rule 94, is this Court's more recent interpretation of the *Doctor* decision in the *Koster* case. There, it was held unequivocally that the *Doctor* case was on the point of *diversity jurisdiction.*

We recognize that allegations of domination and control of the corporation in a shareholder's derivative action are relevant to the issue of the plaintiff's compliance with Equity Rule 94 (and its present counterpart in Rule 23(b), F. R. C. P.). As this Court held in *Delaware & Hudson Co. v. Albany and Susquehanna R. Co.*, 213 U. S. 435 (1909), such allegations are considered to be factors excusing the necessity of making a demand upon the corporation to institute the action. However, they are most certainly *also relevant* to the question of the proper alignment of the defendant corporation in the action, as is shown by the decisions in the *Doctor*, *Venner* and *Koster* cases.

Although, as the Petitioner points out, the *Delaware & Hudson* decision referred to *Doctor v. Harrington* in the context of its consideration of whether Equity Rule 94 had been complied with, there is no basis for inferring from the *Delaware & Hudson* decision that the holding in *Doctor v. Harrington* was not on the point of diversity jurisdiction, which, as noted above, was the single question before the Court in the *Doctor* case. Furthermore, the fact that the *Delaware & Hudson* case did not involve any question of realignment of the corporate defendant negates any inference that this Court intended to abrogate the interpretation of *Doctor v. Harrington* set forth

in the *Venner* case and in the more recent decision of this Court in the *Koster* case.

We submit that allegations of domination and control of the corporation in a shareholder's derivative action are relevant both to formal compliance with the rules of procedure of the federal court (Rule 23(b), F. R. C. P.) and to the question of the proper alignment of the defendant corporation in a derivative action. However, as to this latter point, *the question is not one of mere formal compliance with the rules but, rather, of the actual facts necessary to confer jurisdiction on the federal courts.* Where, as here, the actual facts are determined to be that the corporation is not dominated or controlled by any one antagonistic to its financial interests in the subject matter of the suit, the principles set forth in the *Doctor, Venner* and *Koster* cases required the realignment of Warners as a party-plaintiff.

Petitioner also cites *Central R. R. Co. of New Jersey v. Mills*, 113 U. S. 249 (1885) (cited by Petitioner as *New Jersey v. Mills*) and *East Tennessee, Virginia and Georgia R. R. Co. v. Grayson*, 119 U. S. 241 (1886) (cited by Petitioner as *Railroad v. Grayson*), to support his contention that Warners should be aligned as a party-defendant irrespective of the absence or presence of domination or control of Warners by persons antagonistic to its interests. We submit that neither of those cases supports Petitioner's position.

Neither the *Mills* nor *Grayson* cases were derivative actions. As appears from those decisions, they were each true class actions brought by the shareholders of the corporations involved to set aside actions taken by the respective corporations which, it was alleged, were *ultra vires.*

In the *Mills* case, the Court described the nature of the suit as follows:

> "The bill is filed by stockholders in the New Jersey Corporation, in behalf of themselves and other stockholders similarly situated, to set aside a lease made by that Corporation, acting in concert with the other defendants, of its railroad and property, in excess of its corporate powers and in fraud of the rights of the plaintiffs. All the defendants unite in defending the acts complained of and in denying the illegality and fraud charged against them. The New Jersey Corporation is in no sense a merely formal party to the suit, or a party in the same interests with the plaintiff; but is rightly and necessarily made a defendant." (113 U. S. at p. 254.)

In the *Grayson* case, the Court described the nature of the suit there involved as follows:

> "We are unable to distinguish this case from that of *New Jersey Central R. R. v. Mills,* 113 U. S. 249. It is brought by a stockholder of the Memphis & Charleston Railroad Co. in behalf of himself and any other stockholders who will contribute to the expenses, to set aside a lease made by that corporation to the East Tennessee, Virginia & Georgia Railroad Co., in excess of its corporate powers, and to restrain the Memphis & Charleston Company from carrying into effect a resolution of its stockholders authorizing a settlement with the East Tennessee, Virginia & Georgia Company by the payment of $400,000, to secure cancellation of the lease. The bill was filed by one of the minority stockholders nine days after the resolution in favor of the settlement was passed, and one of its objects is to defeat this action of the majority. Under these circum-

> stances it is clear that the Memphis & Charleston Company is not a mere formal party, or a party in the same interest with Grayson, but is rightly and necessarily a defendant." (119 U. S. at p. 243.)

Although the Court did not permit the realignment of the corporate defendant in the *Mills* and *Grayson* cases, the reason for not doing so was because the action, in each case, was by a shareholder *against* his corporation, and not "on behalf of and for the benefit of" of his corporation as the Petitioner purports to do in the instant case [Complaint, R. p. 3]. The Court carefully pointed out this distinction in the *Grayson* decision:

> "Grayson is not suing for the Memphis & Charleston Company, but for himself. It is true that a decree in his favor may be for the advantage of the Memphis & Charleston Company, but he does not represent the company in its corporate capacity, and has no authority to do so. As a stockholder, he seeks protection from the illegal acts of his own company as well as the other." (119 U. S., p. 244.)

Accordingly, it was not necessary for the Court in the *Mills* and *Grayson* cases to base its refusal to align the corporate defendants as parties-plaintiff on the ground of domination and control of the corporations by persons antagonistic to its interests. However, for the very reasons that the Court refused to so realign the parties—that the actions there involved were actually against the corporate defendants—the *Mills* and *Grayson* cases are not authority for Petitioner's position herein. To the extent that Petitioner has any standing to bring this suit, *it is because he is ostensibly suing on behalf of and for the benefit of Warners, and not against Warners.*

The decision in *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288 (1936), cited by Petitioner, is in no way pertinent to the issues in the present case. Although the *Ashwander* case was a derivative action, federal jurisdiction was not based upon diversity of citizenship and, accordingly, the question of alignment of the parties did not arise and was not considered by this Court. It is true, as Petitioner states, that the *Ashwander* case held that a shareholder can, in certain cases, maintain a derivative action to assert his corporation's rights even though the refusal of the corporation's board of directors to do so was not prompted by fraudulent intent or legal duress. However, the decision of the Court on this point was solely on the basis of equitable principles applicable to derivative actions in general, whether brought in a state or federal court.

We submit, therefore, that the decision in the present case is entirely consonant with the prior decisions of this Court on the question involved. The fact that the outcome in the *Doctor* and *Venner* cases was different from that in the present case was not caused by the application of different principles of law than the District Court and the Court of Appeals here applied but, rather, resulted from the *record* before this Court. In those cases the record showed that the corporations involved were under the control of persons antagonistic to the financial interests of the corporations. In the present case, it was found *as a matter of fact*, after an extensive trial of the issues, that such antagonistic interests did not exist. Accordingly, the realignment of Warners as a party-plaintiff was proper.

III.

Disagreement Between Petitioner and Warners' Board of Directors as to the Wisdom of Instituting This Litigation Does Not Require or Permit Warners to Be Aligned as a Party Defendant in Determining the Existence of Federal Diversity Jurisdiction.

Petitioner argues (Pet. Br. p. 22 *et seq.*) that "jurisdictional integrity" requires that Warners be aligned in this action as a party defendant because, in effect, Warners' Board of Directors disagrees with Petitioner as to the wisdom of this litigation.[11]

We concede that such disagreement exists—Warners' management being more objective and realistic as to whether Warners' best interests are served by an action to accomplish the results sought by Petitioner in his complaint. However, as demonstrated in the foregoing section of this brief, the question of the proper alignment of the corporation in a derivative action depends upon whether the corporation is in the hands of persons antagonistic to its financial interests which prevent the corporation from asserting its rights, and not upon whether the shareholder and his corporation disagree as to whether to assert an alleged right of the corporation.

The discussion of this point in the District Court's opinion is both logical and persuasive:

> "For a corporation to be 'in antagonistic hands' Koster v. American Lumbermens Mutual Co., supra,

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[11]How, or on what basis, Petitioner concludes that Warners' Board stands revealed "as a sterilized Board" (Pet. Br. p. 22, fn. 11) does not appear. There is no support in the record before this Court nor any other basis for such a statement, which flies in the face of the facts found by the District Court herein [Finding of Fact V, R, p. 76].

330 U. S. at 523, or to have a 'hostile attitude,' Cutting v. Woodward, supra, at 255 F. at 635 such as would permit alignment on the side against its presumptive financial interests, surely requires more than a mere argument or difference of opinion between the corporation and the suing stockholders as to the desirability of bringing the suit. Patently, if difference of opinion were all the 'controversy' required to be shown between the stockholder and his corporation in order to preclude alignment of the latter with the plaintiff-stockholder, then there can be no occasion for all the pages of discussion of corporate domination or control, since every stockholder's derivative suit is by definition predicated upon the assumption that the corporation has refused to sue." (117 F. Supp. 781, at 802.)

Petitioner also contends that the realignment of Warners as a party-plaintiff is at the expense of "jurisdictional integrity" because it conflicts with the principles governing alignment in diversity jurisdiction cases set forth in *Indianapolis v. Chase National Bank, supra.* We submit that no such conflict exists and that, in fact, a conflict would arise if Warners were not so realigned.

The *Indianapolis* case, although it involved federal diversity jurisdiction, was not a shareholder's derivative action. The plaintiff, Chase National Bank, a New York corporation, was the trustee under a mortgage to secure certain bonds issued by the Indianapolis Gas Co., an Indiana corporation, which leased all of its assets to the Citizens Gas Co., also an Indiana corporation. During the term of the lease, the franchise of Citizens Gas Co. expired and all of its property, including the leased property, was conveyed to the City of Indianapolis. The City disaffirmed any obligations under the lease and the plain-

tiff brought an action in the federal court, on the basis of diversity jurisdiction, to compel the City's performance under the lease, joining the City, Citizens Gas Co. and Indianapolis Gas Co. as defendants. The lower federal courts rejected a contention made by the City and Citizens Gas Co. that the Indianapolis Gas Co. should be aligned in the action as a party plaintiff. There was a divergence of views in the majority and minority opinions of this Court as to what were the facts. However, the majority opinion, finding that it was by agreement with Indianapolis Gas Co. that the plaintiff instituted the action and that the basic dispute was between Indianapolis Gas Co. and the other defendants, held that Indianapolis Gas Co. should be realigned in the action as a party plaintiff and, therefore, diversity jurisdiction did not exist.

The decision in the *Indianapolis* case did not discuss, and had no need to consider the special rules relating to the alignment of the corporate defendant in a shareholder's derivative action, whereby the nominally corporate defendant,[12] in whose behalf and in whose interest the action is brought, is permitted to remain aligned as a defendant when it is in the hands of persons antagonistic to its interests.

Clearly, under the decision in the *Indianapolis* case, "the primary and controlling matter in dispute" in this action is the validity of the Warners-United contract and, essentially, Petitioner and Warners must be aligned

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[12]*Cohen v. Beneficial Industrial Loan Corp.*, 337 U. S. 541; 548 (1949).

on the same side in this dispute. Petitioner has instituted this action on behalf of Warners; the alleged cause of action is Warners'; any recovery obtained by Petitioner goes to Warners. The disagreement between Petitioner and Warners' Board as to the wisdom of bringing this action is ancillary to the litigation and cannot be converted into a basis for ignoring the principle that the parties are to be aligned according to their sides in the "primary and controlling matter in dispute."

As we have noted above, in Section I of this brief, this ancillary disagreement is essential to a shareholder's standing to bring a derivative action, and the adoption of Petitioner's theory would, therefore, greatly expand the scope of federal diversity jurisdiction of such cases. The wisdom,[13] as well as the logic and propriety,[14] of the present limited encroachment upon the jurisdiction of the state courts' jurisdiction, by virtue of the *Doctor*, *Venner* and *Koster* cases, has been questioned. We can perceive of no reason or justification for any further encroach-

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[13]*Lavin v. Lavin, supra.*

[14]"Resort to such realignment seems the only logically consistent course to determine whether in the case at bar there is involved the necessary diversity of citizenship. In addition to such logical considerations, I should have thought weight ought to be given to the fact that 'the dominant note in the successive enactments of Congress relating to diversity jurisdiction is one of jealous restriction, of avoiding offense to state sensitiveness, and of relieving the federal courts of the overwhelming burden of 'business that intrinsically belongs to the state courts' in order to keep them free for their distinctive federal business.' City of Indianapolis v. Chase National Bank, 314 U. S. 63, 76, 62 S. Ct. 15, 20, 86 L. Ed. 47." (*Ashley v. Keith Oil Co.*, 73 Fed. Supp. 37, at p. 53 (D. Mass., 1947) (Opinion by Judge Wyzanski).)

have brought the derivative suit, his corporation must have refused to bring the action. In Section II of our brief, we discuss the decisions of this Court[8] establishing the principles on which the corporate defendant in a shareholder's derivative action is to be aligned either as a defendant or as a plaintiff, depending upon the circumstances in each case. In the cases there discussed, this Court has recognized that, under certain limited and special circumstances, and contrary to the general principle that all actions are to be prosecuted in the name of the real party in interest (which, in a derivative action, the corporation certainly is), the corporation may be aligned as a party-defendant. If Petitioner's theory were adopted, those decisions and the rule of alignment they enunciate would be rendered meaningless, and the anomalous situation in the law which they represent as an exception to the real party in interest rule would be greatly expanded without any reason or justification therefor.

In referring to this situation, Judge Learned Hand has stated as follows:

> "It may indeed be doubted whether, as an original question, the Supreme Court would not today align the corporation as a party plaintiff in all cases." (*Lavin v. Lavin*, 182 F. 2d 870, 871 (2 Cir., 1950).)

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[8]*E.g., Doctor v. Harrington*, 196 U. S. 579 (1905); *Venner v. Great Northern Railway Co.*, 209 U. S. 24 (1908); *Koster v. (American) Lumbermens Mutual Cas. Co.*, 330 U. S. 518 (1947).

II.

Warners Was Properly Realigned as a Party-Plaintiff in View of the Facts Found by the District Court.

The District Court found, in the present case, that neither Warners, its Board of Directors or stockholders were, at any time, dominated or controlled by anyone antagonistic to the financial interests of Warners [Findings of Fact IV and V, R. pp. 75-77]. The court also found that the directors and officers of Warners were in no way disqualified from enforcing Warners' rights by reason of any matters or facts set forth in the complaint, or otherwise [Finding of Fact V, R. p. 76]. In other words, the situation found by the District Court was one which showed that Warners was fully able to assert all such legal rights which, in the judgment of an independent Board of Directors, it was in the interests of Warners to assert.

The issue of the proper alignment of a corporate defendant in a shareholder's derivative action has come before this Court a number of times and, in each case, this Court has held that the only basis on which the corporate defendant is to be aligned as a defendant in the action for the purpose of determining diversity jurisdiction, is when the corporation is disabled from protecting its own interests because it is dominated or controlled by persons antagonistic to its interests.

Doctor v. Harrington, 196 U. S. 579 (1905);

Venner v. Great Northern Railway Co., 209 U. S. 24 (1908);

Koster v. American Lumbermens Mutual Cas. Co., 330 U. S. 518 (1947).

In the *Koster* case, the most recent utterance by this Court on the subject, the Court recognized the anomaly this rule created with respect to the general principle that all actions are to be prosecuted in the name of the real party in interest.[9] The Court said:

> "The cause of action which such a plaintiff brings before the Court is not his own but the corporation's. *It is the real party in interest* and he is allowed to act in protection of its interests somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself. If, however, such a case as this were treated as other actions, the federal court would realign the parties for jurisdictional purposes according to their real interests. In this case, which is typical of many, this would put Lumbermens on the plaintiff's side. Illinois corporations would then appear among plaintiffs and among defendants and jurisdiction would be ousted. *Indianapolis v. Chase Nat. Bank,* 196 U. S. 579. But jurisdiction is saved in this class of cases by a special dispensation because the corporation *is in antagonistic hands. Doctor v. Harrington,* 196 U. S. 579." (330 U. S. at 522-523.) (Emphasis added.)

The Petitioner correctly notes that in both the *Doctor* and the *Venner* cases, this Court refused to realign the corporate defendants as parties-plaintiff. However, this fact does not lessen the force of the jurisdictional rule enunciated in those cases—that the corporate defendant in a shareholder's derivative action will be aligned as a party-defendant only where it is under the domination and control of persons antagonistic to its interests in the subject matter of the litigation.

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[9]F. R. Civ. Proc. Rule 17(a).

In both the *Doctor* and the *Venner* cases, the record before this Court consisted only of the allegations of the complaint which showed that the corporations involved were dominated and controlled by persons antagonistic to the corporations' interests in the subject matter of the litigation. The opinions rendered in those cases clearly show that the Court considered the presence of the alleged domination and control as the key factor in its conclusion that the corporations there involved should be aligned as defendants, and in its consequent formulation of the exception to the real party in interest rule, which, but for such exception, would have required the corporation to be aligned as a plaintiff.

This conclusion is borne out by the decision in *Koster v. (American) Lumbermens Mutual Cas. Co., supra,* wherein the Court stated, as indicated above:

> ". . . jurisdiction is saved in this class of cases by a special dispensation because the corporation is in antagonistic hands. *Doctor v. Harrington,* 196 U. S. 579." (330 U. S. at p. 523.)

In the instant case, the facts before the Court are contrary to those which confronted it in the *Doctor* and *Venner* cases. Here, the District Court has made findings, which are supported by the evidence in the record, that Warners is not dominated or controlled by anyone antagonistic to its interests. Accordingly, under a proper application of the principle set forth in the *Doctor, Venner* and *Koster* cases, Warners was required to be realigned as a party plaintiff, as was done.

The Petitioner argues that, to the extent the *Doctor* and *Venner* decisions refer to the existence of domination and control of the corporation by antagonistic interests,

they were concerned only with procedural compliance with former Equity Rule 94 (now Rule 23(b) F. R. C. P.) and not with the existence of federal diversity jurisdiction. We submit that those cases will not bear such interpretation.[10]

For one thing, both of those cases involved questions certified to this Court. In *Doctor v. Harrington,* the question was certified as follows:

> "Whether or not the complainants' bill of complaint showed that there was such diversity of citizenship between the parties complainant and the parties defendant in this case as to be sufficient, under the provisions of the United States Revised Statutes, to confer jurisdiction upon the United States circuit court for the southern district of New York, of this cause." (196 U. S. at p. 579.)

In the *Venner* case, the same question was certified to the Court. (209 U. S. at p. 30.)

Accordingly, we fail to see on what basis Petitioner can properly contend that the decisions in the *Doctor* and *Venner* cases were not concerned with the question of alignment of the parties for the purpose of determining the existence of federal diversity jurisdiction.

Furthermore, an analysis of those cases dispels any illusions as to the fact that the Court there determined the question of federal diversity jurisdiction.

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[10]In arguing for his interpretation of *Doctor v. Harrington*, Petitioner completely ignores the above quoted portion of this Court's opinion in the *Koster* case, which he cited in his Petition for the Writ of Certiorari but which he has omitted from his present Brief.

In the *Doctor* case, which involved a shareholders' derivative suit, the lower court realigned the defendant corporation on the side of the plaintiff shareholder and dismissed the action on the ground that diversity jurisdiction was thereby destroyed. Upon certification to this Court of the jurisdictional question set forth above, the defendant contended that such realignment was proper since the interests of the corporation and the complainants were identical in the subject matter of the litigation. The Court pointed out, however, that the record before it (which consisted solely of the pleadings) showed that:

> "The defendant corporations are alleged to be under the control of John J. and Dennis A. Harrington, and that complainants are unable to secure any corporate action on the part of the defendant, the Sol Sayles Company, to redress the wrongs complained of. It is also alleged that the Harringtons controlled the action of the stockholders, and have declined to redress the wrongs complained of or give complainant any opportunity to lay before the Board of Directors or the stockholders of the Sol Sayles Co. the facts alleged." (196 U. S. at p. 588.)

On the basis of the facts thus before this Court, it was held that the corporation was properly aligned as a defendant in the action.

The fact that the decision of this Court in *Doctor v. Harrington* dealt with the question of federal diversity jurisdiction, and not Equity Rule 94, is supported by the decision rendered by this Court only three years later, in the *Venner* case. The Court, in the *Venner* case, considered as separate and distinct issues (1) the question of alignment in relation to diversity jurisdiction and (2) compliance with Equity Rule 94. As in the *Doctor* case,

ments in cases, such as the present case, involving state law and primarily of state interest.

Petitioner has access to the state courts to enforce such rights as he believes he has and the state courts have unquestioned jurisdiction over this class of cases. We submit that, under the facts involved in the instant case, he must be remitted to the state forum since federal jurisdiction is lacking.

Conclusion.

For the foregoing reasons, it is respectfully submitted that the judgment of the Court of Appeals affirming that portion of the judgment of the District Court dismissing the first cause of action of the complaint should be affirmed.

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IN THE

Supreme Court of the United States

October Term, 1956.

No. 316

CHARLES B. SMITH, as Special Administrator of the Estate of EDWARD S. BIRN, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROS. PICTURES, INC.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief for Respondents, Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner.

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SUBJECT INDEX.

PAGE

Question presented 1

Statement of the case 2

Summary of argument 7

Argument 10

I.

A federal court in a diversity case (a) must determine the facts relating to jurisdiction, (b) may do so separately from and in advance of any other issue, and (c) may then on the facts align the parties irrespective of the formal arrangement made in the pleadings 11

II.

Both reason and the decisions of this court require alignment for jurisdictional purposes of the corporation with the complaining stockholder unless, as a fact, the corporation is so dominated and controlled that it is under disability to protect or secure its own interests 13

(a) The general rule in a derivative action requires the alignment of the corporation with the complaining stockholder, except when the corporation is in antagonistic hands 13

(b) The antagonism justifying the exception is antagonism to the true interests of the corporation 14

III.

The fact that Warner would not have brought this action and resisted plaintiff's attempt to maintain it in a federal court does not require Warner to remain aligned as a defendant 24

Conclusion 31

Appendix. Pertinent statutes involved ..... App. p. 1

TABLE OF AUTHORITIES CITED

CASES — PAGE

Ashwander v. Tennessee Valley Authority, 297 U. S. 288, 80 L. Ed. 688 ..... 19, 22, 25

Chicago v. Mills, 204 U. S. 321 18

City of Dawson v. Columbia Ave. Savings Fund, 197 U. S. 178, 49 L. Ed. 713 13

City of Indianapolis v. Chase National Bank, 314 U. S. 63, 86 L. Ed. 48 ..... 12, 19, 20, 24, 30

Cohen v. Beneficial Industrial Loan Corp., 337 U. S. 541, 93 L. Ed. 1528 ..... 21, 25

Delaware & Hudson Co. v. Albany & Susquehanna Railroad, 213 U. S. 435, 53 L. Ed. 862 ..... 16, 17, 18, 21, 23

Doctor v. Harrington, 196 U. S. 579, 49 L. Ed. 606 ..... 14, 15, 17, 18, 21, 22, 23

Erie v. Tompkins, 304 U. S. 64, 82 L. Ed. 1188 ..... 19, 25

Findley v. Garrett, 109 Cal. App. 2d 166, 240 P. 2d 421 26

Fornaseri v. Cosmosart Realty Corp., 96 Cal. App. 549, 274 Pac. 597 26

Gilbert v. David, 235 U. S. 561, 59 L. Ed. 360 11

Hawes v. Oakland, 104 U. S. 450, 26 L. Ed. 827 ..... 21, 22

Koster v. (American) Lumbermen's Mutual Casualty Co., 330 U. S. 518, 91 L. Ed. 1067 ..... 13, 14, 18, 20, 21, 22

KVOS v. Associated Press, 299 U. S. 269, 81 L. Ed. 183 11

McNutt v. Gen. Motors Acc. Corp., 298 U. S. 178, 80 L. Ed. 1135 11

National Labor Relations Board v. Pittsburgh Steamship Co., 340 U. S. 498, 95 L. Ed. 497 4

New Jersey v. Mills, 113 U. S. 249, 28 L. Ed. 949 ..... 15, 16

North Pacific S.S. Co. v. Soley, 257 U. S. 216, 66 L. Ed. 203 11

Pacific Railroad Co. v. Ketchem, 101 U. S. 289, 25 L. Ed. 932 12

Railroad v. Grayson, 119 U. S. 240, 30 L. Ed. 382 ..... 15, 16

PAGE

Reid v. Robinson, 64 Cal. App. 46, 220 Pac. 676 27
Removal Cases, 100 U. S. 457, 25 L. Ed. 593 ..... 12, 16
Smith v. Lewis, 211 Cal. 294, 295 Pac. 37 27
Venner v. Great Northern Railway Co., 209 U. S. 24, 52 L. Ed. 666 ..... 15, 17, 18, 21, 23
Whitten v. Dabney, 171 Cal. 621, 154 Pac. 312 27

RULES

Equity Rule 94 ..... 17, 21, 22, 23
Federal Rules of Civil Procedure, Rule 17(a) 13
Federal Rules of Civil Procedure, Rule 23(b) 8, 15, 17, 18, 21, 25
Federal Rules of Civil Procedure, Rule 27 21
Federal Rules of Civil Procedure, Rule 42(b) 11
Rules of the United States Supreme Court, Rule 40.1(d)(2) 4

STATUTE

Act of March 3, 1875 (18 Stats. 470) 12

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Brief for Respondents, Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner.

Question Presented.

We believe the case presents only one question and that is:

(1) When facts are found after a full trial upon the issue of jurisdiction, during which each side presented all evidence relevant to that issue, and the facts found establish that the acts of the corporation were in good faith, without fraud, and there is and was no control or domina-

tion at any time of the Board of Directors of the corporation or wrongful participation by any director or officer in the making of a contract, and where it is also found that the corporation was not in the hands of anyone antagonistic to its interests, should the dismissal of the action for lack of jurisdiction, after realigning the corporation as a plaintiff, be reversed?

Statement of the Case.

This is a derivative suit brought by a citizen of New York as a stockholder against his corporation, Warner Bros. Pictures, Inc., a Delaware corporation (Warner); two officers thereof, each a citizen of California; United States Pictures, Inc., a Delaware corporation (United); and a shareholder of the latter, a citizen of California. The complaint alleged that two officers of Warner, Harry M. and Jack L. Warner, together with their brother Albert, owned a controlling block of the capital stock of Warner and controlled and dominated the corporation and its Board of Directors [R. p. 5]; that the individual defendants had illegally and wrongfully conspired to divert the assets of Warner and enrich United and Sperling, a son-in-law of H. M. Warner [R. p. 5], through the making of a contract between Warner and United for the production of motion pictures by United to be partly or wholly financed, distributed and exhibited by Warner [R. p. 6], which constituted waste and diversion of assets [R. pp. 8-9] and was a wrongful gift to United at the expense of Warner [R. pp. 9-10]; that plaintiff had made no demand upon the directors because all or a majority had wrongfully participated in the acts complained of and such board was controlled by the active wrongdoers [R. p. 11].

Warner and its two officials answered, denying all allegations of control, conspiracy and wrongful participation [R. pp. 21-22], and asserting the bar of the Statutes of Limitations [R. p. 25] as did United and its stockholder [R. p. 16 *et seq.*]. When the case came on for trial, the court, deeming that the pleadings raised the question of jurisdiction; ordered that issue to be tried first, together with the issue of the application of Statutes of Limitation [R. p. 72]. The matter of limitation was not reached by the trial court and will not hereafter be mentioned. After such trial, in which the parties offered all evidence deemed material and which the trial court noted was practically coextensive with the merits (117 Fed. Supp. 781 at 804), the trial court made Findings of Fact [Finding IV, R. pp. 74-75] to the effect that the contract had been made in good faith and without fraud, was intended by the Board of Directors to be a financial benefit to Warner, was considered by the Board of Directors to be a sound business arrangement for the best interests of the corporation, and that the officers and the Board acted in good faith and exercised their independent business judgment. It found that the brothers Warner owned less than 20%[1] of the outstanding stock and that neither the corporation nor the directors or officers at that or any other time were under the domination or control of the brothers Warner, and that neither the stockholders, its officers or directors were at any time antagonistic to the financial interests of Warner. It found [Finding V, R. p. 76] that it was not true that all or a majority or any of the Board and officers of Warner had wrongfully participated in the acts complained of, and it

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[1]Actually about 15%—See Stipulation of Facts [R. p. 28].

was not true that said Board was dominated or controlled by any of the individuals. It found that it was not true that if plaintiff had made a demand for redress to Warner that those to whom the application would be made would have been disqualified from faithfully doing their duty, and further, that there was no domination or control of the stockholders of Warner, nor was the corporation at any time in hands or under control antagonistic to its financial interests.

The record was examined by the Court of Appeals herein and the findings of fact were approved [Opin., R. p. 669; 237 F. 2d 317 at 320], the findings being set forth in full in the opinion of that court [R. pp. 666-669; 237 F. 2d 317 at pp. 318-320].

On the basis of these facts, the trial court concluded that Warner should be realigned as a party plaintiff, that then diversity no longer existed and the court was without jurisdiction [R. pp. 79-81]. The Court of Appeals affirmed this result [R. pp. 665-671; 237 F. 2d 321-322].

Petitioner's statement herein, in addition to mingling his own inferences with fact, includes matter (Pet. Br. pp. 6-12) apparently presented to demonstrate that the findings of the trial court herein were not supported by the evidence. This was an argument which was made by petitioner to the Court of Appeals herein and was rejected by it [Opin., R. p. 669; 237 F. 2d 320]. Any question concerning the propriety of the findings would be beyond the scope of the petition herein (*Cf.* Sup. Ct. Rule 40.1 (d)(2)). Furthermore, this court has often said that it will not ordinarily review a conflict of evidence or assess the weight or preponderance thereof (see *N. L. R. B. v. Pittsburgh Steamship Co.*, 340 U. S. 498 at 503, 95 L. Ed. 497 at 482), and the inference advanced by petitioner

in this respect would at most create such a conflict with the preponderance of evidence in the record.[2]

The contract of which petitioner complains was made in 1945 and provides for the production by United of 6

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[2]Supporting evidence in the record included the following: The Warner Board consisted of 11 members [R. pp. 27 and 74], including one vacancy filled in November, 1945 [R. p. 27]. Neither Harry M. Warner nor J. L. Warner attended or participated in the meeting of September 25, 1945 at which the contract was proposed [R. p. 602] or that of September 28, 1945 at which it was approved [R. pp. 605-606]. Directors Friedman and Schneider testified in person [R. pp. 443 and 507], all others testified by deposition. Catchings had no connection with Warner, except as a director [R. pp. 245-246]. He had voted for the contract independently and considered it good [R. pp. 247, 248, 249, 254 and 257]. The brothers Warner did not dictate [R. p. 261] or attempt to force candidates on the Board [R. pp. 262-263]. He had confidence in the recommendations of the executives [R. p. 268]. Guggenheimer, a lawyer, used his independent judgment [R. p. 273] and no one had stated directly or indirectly how he should vote [R. pp. 275-276] or made suggestions or requests [R. p. 278]. He represented a large number of shares of clients [R. p. 284]. Wolf, a lawyer, had not had any suggestions or instructions from anyone how to vote [R. pp. 287-290]. Schneider testified the making of contracts for independent productions was beneficial [R. pp. 522-523] and advancing money or financing pictures was the regular business of Warner [R. p. 554]. The other directors each testified his action, as a director in connection with the United contract, was quite independent, was in the exercise of his best judgment, and no directions or requests of any kind had been given as to such vote or what attitude should be taken [See Carlisle, R. pp. 177, 182, 187 and 188; Perkins, R. pp. 297, 298, 300 and 304; Albert Warner, R. pp. 237, 239 and 240]. Carlisle testified a distribution fee of 20% was profitable [R. pp. 194-195]. Friedman, prior to the meetings, had made a complete written analysis of the contract [R. p. 446] and made a full presentation to the Board [R. pp. 453-454]. Friedman did not consider the brothers had either actual or working control [R. pp. 490-491]. The brothers had influence because they had been executive officers of Warner from its inception and had done well for the corporation through a long period of time and through serious troubles [R. pp. 491-492]. Others than directors testified. The highlights of the contract had been negotiated with Bernhard [Freston, R. p. 391]. The details were negotiated with the attorney for United at arm's length [R. pp. 394-395]. Much of it was based upon a similar independent production contract with Michael Curtiz Productions. [R. p. 409, *et seq.*]

motion pictures to be partly financed and exclusively distributed by Warner [R. pp. 607-647]. Fifty per cent (50%) of such financing was to be furnished by United and the remaining 50% by Warner [R. p. 610]. As distributor of such pictures, Warner was to receive 20% of the gross receipts domestically and 25% for certain foreign distribution [R. p. 617], and after the prior deduction from the gross receipts of the distribution fees and the costs and expenses of production, the net proceeds are divisible equally between Warner and United as received [R. p. 626].

The contract was amended in 1947, 1950 and 1952 to provide for additional photoplays, as to which additional pictures, financing would be furnished 100% by Warner, but on which the distribution fee to Warner was increased to 25% domestic and 30% foreign with division of the net increased to 80% to Warner and decreased to 20% to United [R. pp. 654-655].

It is this contract and its amendments which the plaintiff alleged had been made as a result of the control of Warner by the brothers Warner and to be for the benefit of United and Sperling at the expense of Warner. In 1945, the stock of United had been owned equally by the defendant Sperling, a son-in-law of Harry M. Warner, and Joseph Bernhard, a former officer of Warner [Stip. R. p. 28]. The stock of Bernhard was acquired by Sperling for his family in 1946. At the time of trial, 8 pictures had been made by United under the agreement and even though some had not yet run their normal course

[R. p. 553], all but one had been profitable [Chart, R. p. 660]. The testimony showed that the operations under the contract would show a net profit to Warner of many million dollars, including its receipts for distribution charges [R. pp. 528-529], in addition to indirect benefits. The financial benefits to Warner from the United productions as compared with those of other independent producers whose pictures were distributed by Warner were excellent [Chart, R. p. 659].

The evidence above indicated shows that the contract, its terms, and its operations were in the normal line of business, were not abnormal in nature and could not constitute a grievance nor involve any question of legality unless, as alleged by petitioner, it had been forced upon Warner by virtue of improper control and domination by the individual brothers Warner. At the close of the trial, counsel for these defendants did not admit that Warner was opposing the plaintiff over the legality of the relationship, as petitioner states (Br. p. 11), but did state that the directors would not have brought the suit because they believed the contract was good and advantageous to Warner [R. p. 588].

Summary of Argument.

This is a derivative action in which jurisdiction of the Federal Court depends upon diversity. Jurisdiction must be determined by the court upon the facts. Dependent upon the nature and stage of the proceedings, the determination may be made solely on the allegations of the complaint, or upon the actual facts established by affi-

davits, testimony or other evidence in addition to the pleadings. The facts here on the jurisdictional issue were determined after trial which included stipulations of fact and the introduction of testimony, depositions and records, and facts so obtained are the best and only final basis upon which to test jurisdiction.

Upon these facts, it was the right and duty of the court to arrange the parties accordingly, irrespective of the formal arrangement of parties made in the pleadings. On the facts, the District Court aligned the corporation with the plaintiff who purports to be enforcing the rights of that corporation, and the Court of Appeals affirmed that alignment.

In determining federal diversity jurisdiction, the parties are to be aligned in their true position with respect to the controversy. Rule and decision generally require that any action be brought by the real party in interest and this rule is relevant to determining the position of a party for diversity purposes.

Certain exceptions are allowed to the rule that the action be brought by the real party in interest, but these consist of instances in which the real party in interest is under disability imposed by law or in fact and is hence prevented from proceeding in its own name and in its own interest. Equity, and specifically Rule 23(b) F. R. C. P., permits a derivative suit in the name of a shareholder upon a corporate claim when the corporation refuses or fails to act, but this in itself does not involve federal jurisdiction.

With respect to diversity derivative cases, the decisions of this court establish a special application of the rule of alignment and of the party in interest rule and consider that the corporation occupies a position with respect to the controversy dependent upon the existence or nonexistence of disability to act for itself, thereby meeting the requirements of both general rules.

Such disability is recognized by the decisions of this court as consisting of the domination and control of the actions of the corporation by such persons and to such an extent that the will of the corporation is, in effect, supplanted by that of the individuals exercising such control and the corporation is made to act in a way antagonistic to its own interests.

Here, the facts determined after trial show that there was no domination or control, fraud or other impropriety of the sort, and the allegations of the plaintiff to the contrary were found to be untrue. The business discretion rule is the substantive law of California and does not permit a derivative suit under such circumstances. Denial of allegations of control and domination, or of the existence of disability does not put the corporation in antagonistic hands.

The corporation, being under no recognized disability, should here, as the real party in interest, be aligned with the plaintiff and dismissal for lack of jurisdiction was proper.

ARGUMENT.

The decisions and the principles they establish relating to the alignment of parties in diversity derivative actions have been meticulously and exhaustively set forth in the opinion of the District Court herein (117 Fed. Supp. 781 at 812) and discussed by the Court of Appeals [R. pp. 665-671; 237 Fed. 2d 320-321]. The present case differs from most other reported cases in that here the issue of jurisdiction was formally tried, and findings based on an extensive record were made completely negativing the element of domination or control by any of the persons concerned and establishing positively that the Board of Directors of the corporation had authorized the contract herein in the exercise of its best and independent business judgment. This case, therefore, presents very sharply the question of what the true rule of alignment may be and what are its critical elements. In the interest of brevity, we shall not here repeat the scholarly study set forth in the opinion of the District Court, but we earnestly refer this court to that opinion, though the basis and logic of what we deem to be the rule and the decisions of this court establishing and applying that rule will be here presented.

I.

A Federal Court in a Diversity Case (a) Must Determine the Facts Relating to Jurisdiction, (b) May Do so Separately From and in Advance of Any Other Issue, and (c) May Then on the Facts Align the Parties Irrespective of the Formal Arrangement Made in the Pleadings.

(a) Whenever the jurisdiction of a Federal Court appears in issue, its existence must be determined, and the burden is on the party claiming jurisdiction to show that it clearly exists.

McNutt v. Gen. Motors Acc. Corp., 298 U. S. 178, 80 L. Ed. 1135;

KVOS v. Associated Press, 299 U. S. 269, 81 L. Ed. 183.

(b) Rule 42(b) of the Federal Rules of Civil Procedure contemplates and permits a separate trial of any issue. Such separate consideration has been accepted as proper by this court with respect to the jurisdictional factors in diversity cases.

See

Gilbert v. David (1925), 235 U. S. 561, 59 L. Ed. 360, as to citizenship; and

North Pacific S.S. Co. v. Soley (1921), 257 U. S. 216, 66 L. Ed. 203;

McNutt v. Gen. Motors Acc. Corp. (1935), 298 U. S. 178, 80 L. Ed. 1135;

KVOS v. Associated Press (1936), 299 U. S. 269, 81 L. Ed. 183, as to the amount in controversy.

(c) Following the Act of March 3, 1875, 18 Statutes at Large 470, this court recognized and established the rule of alignment in the *Removal Cases* (1879), 100 U. S. 457, 25 L. Ed. 593, and applied the same rule to actions originally commenced in the Federal Courts in *Pacific Railroad Co. v. Ketchem,* 101 U. S. 289, 25 L. Ed. 932. This court there held that, without regard to the position the parties occupied in the pleadings, for the purpose of determining jurisdiction the court should ascertain the real matter in dispute and arrange the parties properly on one side or the other with respect thereto. Such examination and alignment has since been made and approved many times and over a long period of time.

City of Indianapolis v. Chase National Bank (1941), 314 U. S. 63, 86 L. Ed. 48;

City of Dawson v. Columbia Ave. Savings Fund (1905), 197 U. S. 178, 49 L. Ed. 713.

II.

Both Reason and the Decisions of This Court Require Alignment for Jurisdictional Purposes of the Corporation With the Complaining Stockholder Unless, as a Fact, the Corporation Is so Dominated and Controlled That It Is Under Disability to Protect or Secure Its Own Interests.

(a) The General Rule in a Derivative Action Requires the Alignment of the Corporation With the Complaining Stockholder, Except When the Corporation is in Antagonistic Hands.

Rule 17(a) of Federal Rules of Civil Procedure provides that every action shall be prosecuted in the name of the real party in interest, with certain exceptions. A stockholder's derivative action is not included as an express exception. The cause of action in a derivative suit is that of the corporation itself. The recovery, if any, goes to the corporation. The jurisdictional amount is measured by the corporate claim and not by that of the individual plaintiff. This court outlines the situation in *Koster v. (American) Lumbermens Mutual Casualty Co.*, 330 U. S. 518, 91 L. Ed. 1067, at 522-523, when it says:

> "The cause of action which such a plaintiff brings before the court is not his own but the corporation's. It is the real party in interest and he is allowed to act in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself. If, however, such a case as this were treated as other actions, the federal court would realign the parties for jurisdictional purposes according to their real interests. In this case, which is typical of many, this would put Lumbermens on the plaintiff's side. Illinois corporations would

> then appear among plaintiffs and among defendants, and jurisdiction would be ousted. *Indianapolis vs. Chase Nat. Bank,* 314 U. S. 63. But jurisdiction is saved in this class of cases by a special dispensation because the corporation is in antagonistic hands. *Doctor vs. Harrington,* 196 U. S. 579."

Petitioner contends (Pet. Br. p. 14) that in a number of early cases, including *Doctor v. Harrington* (1905), 196 U. S. 579, 49 L. Ed. 606, this court rejected the argument that because the corporation would benefit if the complaining stockholder succeeds, it should be considered as a plaintiff. In *Koster,* as is evident from the above quotation, this court cited *Doctor* not as a rejection of the abbreviated argument described by petitioner but as authority for declining to make realignment of the corporation when that corporation was in antagonistic hands.

(b) The Antagonism Justifying the Exception Is Antagonism to the True Interests of the Corporation.

Antagonistic or hostile hands are terms used in a number of cases. This could mean antagonism to the bringing or maintenance of the particular suit, or antagonism to the true interests of the corporation. Petitioner assumes that antagonism of the first category is alone contemplated by the cases in determining realignment. However, it is apparent that a declination on the part of the corporation to bring the suit is an inherent factor in any derivative action. Absent refusal or failure on the part of the corporation, there would be no suit by a stockholder and yet a refusal or failure, irrespective of its reasons, would be counted by the petitioner as establishing the necessary hostility for jurisdictional purposes.

In so doing, we believe petitioner misuses the elements which determine alignment for federal jurisdictional purposes in that class of diversity cases represented by a derivative suit, with the elements which are requisite in any court of equity as a condition of recognizing plaintiff's right to prosecute a claim of his corporation. On petitioner's theory, every derivative action in which diversity is arranged by the plaintiff and in which there is procedural compliance with Rule 23(b) F. R. C. P., could be brought or would remain in the Federal Court. The comment of the trial judge in this case is very pertinent when he said in his opinion (117 Fed. Supp. at p. 802):

> "Patently, if difference of opinion were all the 'controversy' required to be shown between the stockholder and his corporation in order to preclude alignment of the latter with the plaintiff-stockholder, then there can be no occasion for all the pages of discussion of corporate domination or control, since every stockholder's derivative suit is by definition predicated upon the assumption that the corporation has refused to sue."

It is true, as petitioner states, that this court declined to approve realignment of the corporation in *New Jersey v. Mills* (1884), 113 U. S. 249, 28 L. Ed. 949; in *Railroad v. Grayson* (1886), 119 U. S. 240, 30 L. Ed. 382; in *Doctor v. Harrington* (1905), 196 U. S. 579, 49 L. Ed. 606, and in *Venner v. Great Northern Railway Co.* (1908), 209 U. S. 24, 52 L. Ed. 666. In each of these cases the facts as they stood before the court were diametrically opposite to those found to be true in the present case. *Doctor* and *Venner* were each on the pleadings where the facts consisted of the allegations and, in each

of those, the essential allegations asserted the complete domination and control of the corporation, its Board and its stockholders by the person or persons who are asserted to have done the wrong and reaped the benefit. No other factual matter is emphasized. In *New Jersey v. Mills* and *Railroad v. Grayson*, the terms "domination and control" were not used, but in each the fact was present. In *New Jersey* it was alleged that application to the corporation for redress would have been futile because the individuals concerned were actively engaged in the wrong, and the conclusion of futility could not have been accepted by this court unless the individuals concerned did control the corporation. In *Railroad v. Grayson*, it was noted that, in the allegations of the bill, a majority of the stockholders of the corporation had combined with the other corporation involved in the wrong so that, while no individuals appeared to be so charged, the control did exist and was employed to sacrifice the interests of the corporation. In neither case was there discussion of the fact of control, but it was noted, and discussion was not required because in each the actual grievance alleged was an *ultra vires* act of the corporation, thereby giving rise to a real complaint by a stockholder against his own corporation. Both cases followed very shortly after the *Removal Cases* and may be considered to be in the formative stages of the rule. Petitioner states (Pet. Br. p. 15) that there is nothing in either case to suggest that the managements of the corporations were controlled or dominated; but clearly each did present an instance of domination and control.

Petitioner likewise cites *Delaware & Hudson Co. v. Albany & Susquehanna Railroad*, 213 U. S. 435, 53 L. Ed. 862, as a contrary holding. That case came up on the

facts after trial and was certified upon the single question put by the Court of Appeals as to whether the bill could be maintained for failure to comply with Equity Rule 94, the Court of Appeals stating that the question had been held to be jurisdictional under *Doctor v. Harrington*. In *Delaware* the certified facts showed that the directorates of the two corporations involved were interlocking in that a majority of the Board of Susquehanna were also officers, directors or employees of Delaware. This court did not discuss the question of realignment in any way and we submit that the obvious reason lies in the complete domination of the corporation by the same persons who were the officers and directors of the other corporation. It does discuss *Doctor*, quoting therefrom the allegation of control and domination and holds that in *Doctor*, though there had been no literal compliance with Rule 94, the facts showed the equivalent and excused the necessity for alleging the particulars of a demand under that rule.

In all of these cases, there was then, as a fact, the existence of domination and control and the emphasis in *Doctor* and *Venner* is on that fact alone. The cases do illustrate, however, the necessity for keeping in mind the sharp distinction between the jurisdictional and the merely equitable factors. Domination and control may be, and often is, common to both factors, and this is so in the present case. Plaintiff alleged it to be the reason and excuse why he had made no demand [Compl. par. 24, R. p. 11]. In this instance, the allegation, though found to be untrue, was made to comply with the equitable requirements now established in Rule 23(b) F. R. C. P. The plaintiff also alleged essentially the same matter as part of his cause of action, that is to say, the reason why the contract here involved was wrongful. [*Cf.* Compl. par. 10, R. pp. 6-23, R. p. 10]. Nevertheless, petitioner asserts

(Pet. Br. p. 17) that the sole function of the court in a diversity case is to determine the true matter in controversy, ascertain on which side of that controversy each party really is, and align them accordingly. This is, we believe, the situation in diversity cases as a general class but, as respects derivative actions, this could represent the whole rule only if basic language in the derivative case decisions is completely disregarded. In *Doctor*, the court described the situation as:

> "The ultimate interest of the corporation made defendant may be the same as that of the stockholder made plaintiff; but the corporation may be under a control antagonistic to him, and made to act in a way detrimental to his rights. In other words, his interests and the interests of the corporation may be made subservient to some illegal purpose."

In applying that description in that case, only the fact of domination and control of *Harrington* is stated and repeated, and it appears that domination and control was clearly the factor by which the corporation was made to act in a certain way for an illegal purpose and against the corporate interests. The decision in *Venner*, following *Doctor* by only three years, in considering only the jurisdictional question, again repeats this language from *Doctor*, both as to the description of the circumstance and the fact which caused the corporation to be made to act in such a way. In *Koster, Doctor v. Harrington* is cited as establishing the special case when "the corporation is in antagonistic hands."

In cases such as *Delaware & Hudson Co. v. Albany & Susquehanna Railroad*, 213 U. S. 435 (Pet. Br. p. 16) and *Chicago v. Mills*, 204 U. S. 321, there was no problem of alignment but only of the requirements of equity, and in equity, as is evident from Rule 23(b) F. R. C. P.,

a derivative suit may be permitted, when a corporate cause of action exists, if there is refusal or failure on the part of the directors to afford redress. Under federal equity principles, at least at that time, suit was submitted irrespective of the reasons for refusal, or whether or not such refusal or failure was attributable to a sinister attitude. Such conclusion is not necessarily true under state law, but the cited cases preceded *Erie v. Tompkins* (1937), 304 U. S. 64; 82 L. Ed. 1188, and apparently did not take any possible impact of state law into consideration. But in the derivative cases where alignment has been discussed and jurisdiction considered, the decisions include the additional element of control or domination resulting in antagonism.

Petitioner cites *Ashwander v. Tennessee Valley Authority* (1935), 297 U. S. 288, 80 L. Ed. 688, and *City of Indianapolis v. Chase National Bank*, 312 U. S. 62; 86 L. Ed. 48, and they illustrate the distinctions which must be made herein between diversity cases in general, and derivative suits in particular, for jurisdictional purposes, and the equitable requirements.

Ashwander was a derivative but not a diversity case, for jurisdiction there existed because the defendant was an agency of the Federal Government and a federal question concerning the power of that defendant was presented. There was, therefore, no necessity whatever to consider realignment on any ground or for any reason. The only issue in that case of any interest in the consideration of the present case was whether in equity the plaintiff was entitled to prosecute the suit. It was held that he was so entitled for two reasons, first, because the plaintiff was not merely challenging the right of the Board of Directors to exercise their business judgment and second, because

the managing Board had refused or failed to take action. In such a case, where federal jurisdiction existed on other grounds and no problem of realignment arose, the reasons for the failure or refusal of the Board to take action might be immaterial, but the reference to the business judgment rule appears to indicate the contrary. Only the right of a stockholder to seek equitable relief was involved and this required the two elements noted. It is with respect to this equitable right and not with respect to any jurisdictional question that this court made the statement quoted by petitioner on page 16 of his brief, and such statement is applicable only to a derivative action where no question of jurisdictional realignment was involved.

City of Indianapolis v. Chase National Bank was a diversity but not a derivative case. This decision is cited several times by petitioner. The decision was by a divided court in which there was an apparent divergence of views as to the facts. The prevailing opinion states that in a diversity case the parties should be aligned in accordance with the determination as to whether there was a collision of interests with respect to the primary matter in dispute. *Chase,* as the plaintiff, was trustee under a bond issue and not a shareholder of the gas corporation. It is clear from the opinion of the majority that *Chase* and its mortgagor, Indianapolis Gas Company, had cooperated prior to the bringing of the suit and that it was by agreement that *Chase* had instituted the suit. Had this been a derivative case, such action would have been collusive and such factor alone would have prevented maintenance of the action. The court in this case had no need to consider what has been called by this court the peculiar nature of derivative suits. (*Koster v. Lumbermens etc. Co.,* 330 U. S. 518 at 522.)

The equity procedural requirements which appear to be interjected, even when federal diversity jurisdiction is the only issue (*Cf. Doctor v. Harrington*), are presently laid down in Rule 23(b) of Federal Rules of Civil Procedure. This rule reflects the substance of former Rule 27 and the earlier Equity Rule 94 and, of course, this had followed the decision of this court in *Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827. Rule 23(b) establishes certain procedural requirements of the complaint, including averment of ownership of stock at the right time, a statement that the action is not collusive, and with particularity, the efforts of the plaintiff to secure the desired action from the directors and, if necessary, from the shareholders, or the reasons for failure.

The purpose and effect of the equity rule has been determined by this court: (a) as prescribing the manner in which jurisdiction otherwise existing shall be exercised; (b) as establishing a controversy which may be entertained by a court of equity; and (c) as designed to secure the federal courts from imposition upon their jurisdiction in such cases.

Venner v. Great Northern Railway Co., 209 U. S. 24, 52 L. Ed. 666;

Delaware & Hudson Company v. Albany & Susquehanna Railroad, 213 U. S. 435, 53 L. Ed. 862;

Koster v. (American) Lumbermens Mutual Casualty Co., 330 U. S. 518, 91 L. Ed. 1067;

Cohen v. Beneficial Industrial Loan Corp., 337 U. S. 541, 93 L. Ed. 1528.

The distinction between jurisdictional elements and compliance with the rule was sharply noted by this court in *Venner v. Great Northern Railway Co.*, 209 U. S. 24,

where the opinion actually divides the questions into two separate parts and separately discusses them. With respect to the Rule (Equity Rule 94) argument had been made that compliance was essential to jurisdiction, but this court specifically stated that the requirements of the Rule and the principles declared in *Hawes v. Oakland* did not raise the question of jurisdiction, but only prescribed the manner in which it shall be exercised, and that if jurisdiction does actually exist because of diversity but upon pleadings or proof, a case is not shown to fall within the Rule or the decisions, then it should be dismissed, not for lack of jurisdiction but on the merits for lack of equity. Failure of allegations or proof *in these respects* creates no defect of jurisdiction but only shows that the particular plaintiff had no right in himself to bring or maintain the suit and hence had no title to do so.

In *Doctor*, as already noted, it is said that the interests of the corporation were being "made" subservient to some illegal purpose. In *Koster* the same thought is expressed when it is said that the corporation "is disabled from protecting itself." In the cases which discuss the equitable requirements alone, the thought of disability is not indicated. Unwillingness to take action on the part of the directors is enough. This was the situation in *Ashwander v. T.V.A.*, 297 U. S. 288 and *supra*, where, since federal jurisdiction already existed, only the equitable requirements were concerned and it is in connection therewith that this court notes that the refusal of the directors might be for a number of reasons in the exercise of their judgment and still a cause of action might exist.

In contrast, in jurisdictional cases such statements are not made, and it is apparent that it is not merely unwillingness on the part of the Board but inability to act which

is the criterion. Clearly, if a Board is unable to act, barring a deadlock, such inability is due to some external factor. In the decisions considered, the corporation was unable to act or was alleged to be unable to act because it was so dominated and controlled that any action it might take would be merely the reflection of the will of the individuals in control and would not be the independent will of the Board. Identification of the corporation with the controlling individuals is, therefore, made and the corporation is aligned as a defendant because it and the individuals charged are really one party.

Petitioner here (Br. p. 22) urges that a fair evaluation, primarily of *Doctor* and *Venner*, would lead to the conclusion that the emphasis in those two cases upon domination and control referred only to the matter of procedural compliance with Equity Rule 94 and was not the basis for jurisdictional ruling. We submit that both cases were certified only on the question of jurisdiction and that, if there were any doubt as to the effect of *Doctor*, it is cleared up in *Venner*. Each case came up essentially on the complaint and the question in each case was simply whether the allegation of complete domination and control was sufficient to require the corporation to be retained as a defendant. Each case does mention the Equity Rule but *Venner* certainly distinguishes the effect of noncompliance with the Rule from any jurisdictional factor. *Delaware v. Susquehanna*, 213 U. S. 435 and *supra*, makes it perfectly clear that there was no impact of procedural compliance in *Doctor*. In *Delaware*, the Court of Appeals had thought that *Doctor* imputed a jurisdictional aspect to compliance with Rule 94, but this court rejected that imputation completely.

III.

The Fact That Warner Would Not Have Brought This Action and Resisted Plaintiff's Attempt to Maintain It in a Federal Court Does Not Require Warner to Remain Aligned as a Defendant.

As his second point herein (Pet. Br. p. 22), petitioner reargues in summary form the contentions previously made and relies upon the same cases, with particular emphasis upon *Indianapolis v. Chase National Bank,* 314 U. S. 62, 86 L. Ed. 48. He urges that Warner is antagonistic to the suit and does not want the Warner-United relationship to be disturbed. In effect, he urges that Warner should not be realigned because "what the complainant wants, Warner and its codefendants do not want." (Pet. Br. p. 24.) His view assumes that any manifestation by the corporation that it is not supporting his side of the claim as he alleged it, must result in alignment of the corporation as a defendant. Even the premise of petitioner's view disregards the fact that what he does and can want is shown by his complaint and is limited by law.

In his complaint, as previously noted, he asserted that the contract was forced upon the corporation as a result of control, domination, and conspiracy. The necessary implication is that the contract would not have been entered into by the corporation in its best interests if it had not been so forced to enter the relationship. The controversy necessarily concerns the question of whether the corporation was forced to make this contract, because plaintiff is not entitled to litigate a disagreement as to what are the best interests of the corporation, nor does such disagreement place the corporation in "antagonistic hands." Essentially the same reasons were alleged to excuse the making of a demand [R. pp. 11, par. 24], but it was found

that control or domination did not exist at *any* time [R. p. 75].

Rule 23(b) is procedural and requires, among other things, a disclosure to the court that the plaintiff has endeavored to obtain his remedy through the corporation itself (*Cohen v. Beneficial Industrial Loan Corp.*, 337 U. S. 541 at 556, 93 L. Ed. 1528 at 1541). The rule requires a statement of the reasons for failure but does not indicate what reasons may be acceptable. This must be determined from the substantive law.

It is established that a stockholder cannot bring a derivative action merely because of a difference of opionion with the Board of Directors as to the advisability of any act or action taken within the business judgment, discretion and power of the Board of Directors. We eliminate from discussion the possible grounds of *ultra vires*, violation of statute and similar things because they are not here involved in any way. This rule, applied in derivative cases and commonly known as the business judgment rule, is recognized as a matter of substantive federal equity in *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, 80 L. Ed. 688, where it was specifically held that one reason why the plaintiff had a right to proceed was because he was not merely challenging the right of the Board of Directors to exercise its business judgment.

Under *Erie v. Tompkins*, 304 U. S. 64, 82 L. Ed. 1188, and subsequent cases, the substantive law of the state is administered in diversity cases by the federal courts, though federal procedural rules apply. Reference to the substantive law of California will, therefore, assist in determining what "the complainant wants" by estab-

lishing what he can want. It is not here suggested that the substantive law of California will directly control federal jurisdiction but it is submitted that, through analysis of what must be in substance the cause of action under state law, the actual controversy in this case may be determined and alignment made accordingly.

The business judgment rule is the law of California, and in *Fornaseri v. Cosmosart Realty Corp.*, 96 Cal. App. 549, 274 Pac. 597, the rule is stated (p. 557) as follows:

> "In the absence of fraud, breach of trust or transactions which are *ultra vires,* the conduct of directors in the management of the affairs of a corporation is not subject to attack by minority stockholders by a suit at equity, where such acts are discretionary and are performed in good faith, reasonably believing them to be for the best interests of the corporation."

The facts of the present case fall within such statement of the rule with complete precision.

California applies the rule to the question of bringing an action, as well as to the act of which complaint is made, and applies it to both foreign and domestic corporations. In *Findley v. Garrett,* 109 Cal. App. 2d, 166, 240 P. 2d 421, the corporation involved was a Delaware corporation as is Warner. The court there said (p. 178):

> "The Board exercised its business judgment. Under such circumstances a stockholder may not usurp the discretionary powers of the managers of the corporation by commencing a derivative action. If, under such circumstances, the court should entertain such an action, it would be substituting its own business judgment for that of the directors. The determination of the matter by the board of directors is a bar to the action herein."

Furthermore, in considering derivative cases and their peculiar nature, the California courts accept and recognize domination and control as the element constituting disability. *Whitten v. Dabney,* 171 Cal. 621; 154 Pac. 312, came up on general demurrer for absence of facts and as barred by the Statute of Limitations. The court, dealing with the allegations, said (p. 629) that:

> "So long as the corporation itself remains under disability and is powerless to act by virtue of the fact that its control is in the hands of its Board of Directors accused of participation in the frauds, the Statute of Limitations does not run against it."

See also *Reid v. Robinson* (1923), 64 Cal. App. 46, 220 Pac. 676.

Reason supports the rule, for certainly the cause of action is that of the corporation and no stockholder could sue unless there was, at the time, a cause of action which could be enforced by his corporation, if it so desired. A corporation would have no cause of action itself, with respect to a contract, unless something were legally wrong with the contract itself by normal standards, such as fraud or lack of consideration, or unless something was wrong with the capacity of the contracting parties, such as disability. In *Smith v. Lewis,* 211 Cal. 294, 295 Pac. 37, it was held, for instance, that a stockholder could not bring action because the corporation itself was not permitted to bring action since it had failed to pay its franchise tax.

Here, the terms of the contract already referred to showed ample consideration and other necessary requireto be valid as a contract. The plaintiff's attack is based upon the capacity of the corporation in that the making of

the contract was not its own true act but was brought about through control exercised as a result of conspiracy. These respondents denied those allegations and such denials thereby raised the jurisdictional issue [R. pp. 21-22]. The facts proved at the trial were contrary to the allegations of the complaint and it was so found. The facts so found showed that there was no cause of action, and in a state court the action would have been dismissed for that reason, because of the applicability of the business judgment rule. In the Federal Court, with jurisdiction based solely on diversity, that ruling and disposition could not be made unless jurisdiction existed.

These matters, as indicated, go to the merits of the case, but, at least in this particular case, the facts going to the merits of the case are also the criteria from which to determine and isolate the controversy for the purpose of federal jurisdictional alignment. It is submitted that, since substantively, the plaintiff cannot complain merely of an unprofitable or improvident contract, then the controversy cannot be the wisdom or merits of that contract. The determination for the purposes of alignment of the parties, with respect to the true controversy, is dependent upon whether the contract was forced upon the Board of Directors so that its discretion was not truly exercised.

When such a case as the present one is brought in a Federal Court, the question of jurisdiction immediately arises. Controversy between the parties as to the existence of jurisdiction cannot itself be a guide in alignment because jurisdiction may not be conferred by agreement or acquiescence of the parties and it is, therefore, quite immaterial what the attitude or arguments of any of the parties may be with respect to the precise question which

determines jurisdiction. As the Court of Appeals in the present case said [R. p. 671; 237 F. 2d 321]:

> "Either jurisdiction subsists or its does not. There is absolute dichotomy."

Here it is submitted that the only substantive controversy is whether the corporation actually exercised its own will and discretion. As to that controversy, Warner did not and does not agree with the plaintiff, but the determination of that controversy here decides jurisdictional alignment. We submit that whether or not the parties agree or disagree or take opposite positions with respect to the facts which determine jurisdiction is beside the point. In the present case, the same facts determine both the existence of a cause of action and jurisdictional alignment, though these are quite separate questions. Here, there was a trial and those facts were determined. The assertions of domination and control, fraud and other impropriety being found by the trial court to be untrue, there could only be the question as to whether the actual contract had been made in the best interests of the corporation, and that question cannot be litigated by a stockholder under California law or under federal law. Certainly a question which cannot be litigated cannot be the question constituting the controversy for the purposes of diversity alignment.

If a corporation is controlled and dominated by the individual codefendants, it is clear that a united defense or the action is a consistent consequence of that control. Such control by the individuals benefiting is the cause, antagonism to the interests of the corporation is the result, and the joint defense is merely one of the almost inevitable effects. However, if there is no control, as the

trial court found to be the situation here, and the Board of Directors, in its independent judgment and believing that the claim that the corporation has been victimized is false, still elects to controvert the claim as alleged and refuses to admit the allegations by silence, then the corporate action is certainly not antagonistic to its own interests, but is a determination as to what are its own best interests by the only body entitled to make that determination.

Petitioner in this section of his brief relies heavily on *Indianapolis v. Chase National Bank,* 314 U. S. 62, 86 L. Ed. 48. This case has previously been discussed herein as a diversity and not a derivative suit. It was concerned only with the general diversity rule and not with the specific problems of a derivative case. Therein the court isolated the controversy as the question whether the assignee of a lease would be bound by its terms. The assignee had declined to be so bound. The basic dispute was between the lessor and the assignee of a lessee on a question of law. In the present case, the contract in itself presents no question of law but, on the contrary, the only question is one of fact as to whether that contract had been forced upon Warner. In the cited case, *Chase* was trustee under a bond issue secured by the assets of the lessor and its interest lay in protecting that security. This court ordered realignment with consequent failure of jurisdiction, since it regarded both the trustee and the mortgagor-lessor as having the same interest. As a matter of fact, the trustee and the lessor had agreed upon the bringing of the suit by the trustee in advance. The case illustrates the necessity for determining what the complainant and any named defendant really want. It has been pointed out herein, as a matter of substantive

law, what the complainant in the present case must want, irrespective of what he says. The cited decision is only favorable to the petitioner here, if his own analysis of what he wants, as expressed in his brief, is accepted as a fact and in disregard of the allegations of his complaint and of substantive law.

Nor is the jurisdictional conclusion here a sacrifice of jurisdictional integrity nor a deprivation of plaintiff's rights, if he has any, upon technical grounds. Neither party could in any way benefit by a judgment on the merits from a court which lacked jurisdiction. Such a judgment would be a nullity and subject to collateral attack at any time. State courts have unquestioned jurisdiction of this class of case and, unless the jurisdiction of a Federal Court is beyond question in the particular case, the litigation should be restricted to the other forum.

Conclusion.

On the basis of the series of decisions by this court and because of the substantive realities, it is respectfully submitted that the judgment of the Court of Appeals, affirming the judgment of the District Court that it lacked jurisdiction, should be affirmed.

Respectfully submitted,

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APPENDIX.

A. Supreme Court Rules. Rule 40(d)(2):

The phrasing of the questions presented need not be indentical with that set forth in the jurisdictional statement or the petition for certiorari, but the brief may not raise additional questions or change the substance of the questions already presented in those documents. Questions not presented according to this paragraph will be disregarded, save as the court, at its option, may notice a plain error not presented.

B. Federal Rules of Civil Procedure. Rule 17(a):

Real party in Interest. Every action shall be prosecuted in the name of the real party in interest; but an executor, administrator, guardian, trustee of an express trust, a party with whom or in whose name a contract has been made for the benefit of another, or a party authorized by statute may sue in his own name without joining with him the party for whose benefit the action is brought; and when a statute of the United States so provides, an action for the use or benefit of another shall be brought in the name of the United States.

C. Federal Rules of Civil Procedure. Rule 42(b):

Separate Trials. The court in furtherance of convenience or to avoid prejudice may order a separate trial of any claim, crossclaim, counterclaim, or third-party claim, or of any separate issue or of any number of claims, cross-claims, counterclaims, third-party claims, or issues.

D. Former Equity Rule 94, 104 U. S. IX:

Every bill brought by one or more stockholders in a corporation against the corporation and other parties, formed upon rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders. and the causes of his failure to obtain such action.